84-1942

Office-Supreme Court, U.S.
FILED
JUN 13 1985
ALEXANDER L. STEVAS,
CLERK

No. ____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

NATIONWIDE MUTUAL INSURANCE COMPANY,
Petitioner,

v.

HENRY GERRARD CLAY,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ALABAMA

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QUESTIONS PRESENTED

1. Whether petitioner's right to an impartial appellate hearing, guaranteed by the Due Process Clause of the Fourteenth Amendment, was violated by the participation in the decision (involving the newly developing tort of bad faith) by a judge who, while this case was under submission in the court of which he was a member, was prosecuting two civil actions seeking punitive damages against insurance companies involving the same legal issue.

2. Whether the award of $1,250,000 in punitive damages based upon a retrospective judicial enlargement of the tort of bad faith violated petitioner's right under the Due Process Clause of the Fourteenth Amendment to fair warning of conduct that will give rise to punishment.

3. Whether the award of $1,250,000 in punitive damages for asserting a legal defense that was nonfrivolous as a matter of law infringed petitioner's right to access to court and assistance of counsel.

4. Whether the award of $1,250,000 in punitive damages for the bad faith handling of a disability claim violated petitioner's rights under the Excessive Fine Clause of the Eighth Amendment, as made applicable to the States through the Due Process Clause of the Fourteenth Amendment, and the Contract Clause, Art. I, § 10, Cl. 1 of the U.S. Constitution.

5. Whether Ala. Code § 12-22-72 (1975), which automatically imposes a mandatory penalty of ten percent of any money judgment on an unsuccessful *defendant*-appellant, but which imposes no corresponding burden on an unsuccessful plaintiff-appellant, is unconstitutional under the Equal Protection Clause of the Fourteenth Amendment.*

*All parties to this case are named in the caption. The ownership of Petitioner Nationwide Mutual Insurance Company rests solely with its policyholders. The following is a listing of all subsidiaries and affiliates of Nationwide Mutual Insurance Company:

Nationwide Mutual Fire Insurance Company, Nationwide Life Insurance Company, Nationwide General Insurance Company, Nationwide Property and Casualty Insurance Company, Nationwide Variable Life Insurance Company, Nationwide Indemnity Insurance Company, National Casualty Company, Michigan Life Insurance Company, Pacific Life Insurance Company, Scottsdale Insurance Company, Farmland Mutual Insurance Company, Farmland Life Insurance Company, Farmland Insurance Company, Colonial Insurance Company of California, NGC County Mutual Insurance Company, Southern Bankers Life Insurance Company, Allnations, Inc., Auto-Direkt Insurance Company, Cedar Springs Life Insurance Company, Columbus Service, GmbH, Corporate Marketing Services, Inc., Cranston-Csuri Productions, Inc., Fazaroli & Davey Administration and Insurance Services, Gates, McDonald and Company, Gates, McDonald and Company of New York, Global Exchange, Gulf Atlantic Life Insurance Company, Hickey-Mitchell Insurance Agency, Inc., I.I.I. Insurance Agency of Texas, Inc., Insurance Intermediaries, Inc., International Cooperative Bank Company, Ltd., Lone Star General Agency, Inc., National Casualty Company of America, Ltd., National Premium and Benefit Administration Company, National Services, Inc., Nationwest Insurance Services, Inc., Nationwide Cash Management Company, Nationwide Communications, Inc., Nationwide Community Urban Redevelopment Corporation, Nationwide Consumer Services, Inc., Nationwide Corporation, Nationwide Development Company, Nationwide Financial Services, Inc., Nationwide Funding, Inc., Nationwide Investing Foundation, Nationwide Investors Services, Inc., Nationwide Foundation, Nationwide/MESCO Insurance Agency, Inc., Nationwide/PEBSCO, Inc., Nationwide Property Management, Inc., Nationwide Separate Account Trust, Nationwide Transport, Inc., Neckura Versicherungs, A.G., Neckura Lebensversicherungs, A. G., NGA, Inc., NSC, Inc., Ohio Farm Bureau Synfuels Investment Company, PEBSCO Municipal Employees Services Corporation, PEBSCO Securities Corporation, Pionier Automobile Insurance Corporation, Public Employees Benefit Services Corporation, Scientific Assistance Corporation, Wesco Securities, Inc., West Coast Life Insurance Company, Western Credit Corporation.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	3
A. Facts material to the questions presented	3
B. How the federal questions were raised	6
1. The disqualification question	6
2. Constitutionality of the punitive damage judgment	7
a. Question two was properly raised in the court below	7
b. Questions three and four are within the scope of Nationwide's attack on the punitive damages judgment and may be raised in this Court	7
3. Constitutionality of Ala. Code § 12-22-72 (1975)	9
C. Reasons for granting the writ	10
1. The disqualification issue	10
a. The financial interest of Justice Embry required his recusal	11
b. Justice Embry's participation infected the entire Alabama Supreme Court with unconstitutional bias	12
2. The issue of fair warning of punitive sanction	13
3. The issue of chilling the assertion of legal rights	15
4. The Excessive Fine Clause and Contract Clause issues	16
5. The unconstitutionality of Ala. Code § 12-22-72 (1975)	16
CONCLUSION	17
APPENDIX	1a

TABLE OF AUTHORITIES

CASES: Page

Aetna Life Ins. Co. v. Lavoie, ____ So.2d ____, 19 A.B.R. 272 (Ala. Dec. 8, 1984), *appeal docketed*, 53 U.S.L.W. 3759 (U.S. April 9, 1985) (No. 84-1601) 5, 6, 9, 11, 13, 16, 18

Allied Structural Steel Co. v. Spannaus, 438 U.S.234 (1978) 16

Boynton v. Commonwealth of Virginia, 364 U.S. 454 (1960) 8

Chavers v. National Sec. Fire & Cas. Co., 405 So.2d 1 (Ala. 1981) 3

City of Brewton v. White's Auto Store, 362 So.2d 226 (Ala. 1978) 14

Dewey v. Des Moines, 173 U.S. 193 (1899) 8

Duncan v. Johnson, 338 So.2d 1243 (Ala. 1976) ... 5, 12, 13

Evitts v. Lucey, 469 U.S. ____, 105 S.Ct. 830, *reh. denied*, 105 S.Ct. 1783 (1985) 17

Ex Parte Alabama Power Co., 280 Ala. 586, 196 So.2d 702 (1967) 5, 12, 13

Frank v. Mangum, 237 U.S. 309 (1915) 14

Furman v. Georgia, 408 U.S. 238 (1972) 16

Gibson v. Berryhill, 411 U.S. 564 (1973) 10

Gulf Atlantic Life Ins. Co. v. Barnes, 405 So.2d 916 (Ala. 1981) 3

Hormel v. Helvering, 312 U.S. 552 (1941) 8, 10

Illinois v. Gates, 462 U.S. 213 (1983) 7, 8, 9

In re Murchison, 349 U.S. 133 (1955) 10

In re Neiswinger, 467 N.E.2d 43 (Ind. App. 1984) 13

Laird v. Tatum, 409 U.S. 824 (1972) 11

Lindsey v. Normet, 405 U.S. 56 (1972) 17

Logan v. Zimmerman Brush Co., 455 U.S. 422 (1982) 15

Marks v. United States, 430 U.S. 188 (1977) 14

Mayberry v. Pennsylvania, 400 U.S. 455 (1971) 13

Table of Authorities Continued

Page

National Sav. Life Ins. Co. v. Dutton, 419 So.2d 1357 (Ala. 1982) 4

New York Times v. Sullivan, 376 U.S. 254 (1964) 15

Offutt v. United States, 348 U.S. 11 (1954) 13

Singleton v. Wulff, 428 U.S. 106 (1976) 8, 10

State ex rel. Mitchell v. Sage Stores Co., 152 Kan. 622, 143 P.2d 652 (1943) 11

State ex rel. Short v. Martin, 256 P.681 (Okla. 1927) .. 11

State ex rel. Wild v. Otis, 257 N.W.2d 361 (Minn. 1977) 11

Terminiello v. Chicago, 337 U.S. 1 (1949) 8

Tumey v. Ohio, 273 U.S. 510 (1927) 10

Tyson v. Johns-Manville Sales Corp., 399 So.2d 263 (Ala. 1981) 14

Vachon v. New Hampshire, 414 U.S. 478 (1974) 8

Ward v. Village of Monroeville, 409 U.S. 57 (1972) 10

Withrow v. Larkin, 421 U.S. 35 (1975) 10

CONSTITUTION, STATUTES AND RULES:

United States Constitution:

Art. I, Section 10, Cl.1 (Ex Post Facto Clause) 2, 13, 14

Art. I, Section 10, Cl.1 (Contract Clause) .. 2, 7, 9, 16

Fifth Amendment (Due Process Clause)..... 2, 7, 14

Eighth Amendment, Clause 2 (Excessive Fine Clause)..... 2, 7, 9, 16

Fourteenth Amendment, Section 1 (Due Process Clause) 2, 10, 14, 16, 17

Fourteenth Amendment, Section 1 (Equal Protection Clause) 3, 17

Federal Statutes:

28 U.S.C. Section 1257(3)..... 2, 11

Alabama Statutes and Rules:

Section 8-8-10, *Code of Alabama* (1975) 4

Section 12-2-14, *Code of Alabama* (1975)..... 5, 7, 12

Table of Authorities Continued

Page

Section 12-22-72, *Code of Alabama* (1975)... 3, 4, 9, 16
Section 27-1-18, *Code of Alabama* (1975) 14
Rule 37, Ala. R. App. P. 4
Alabama Constitution:
Amendment No. 328 Section 6.10..... 5, 12

MISCELLANEOUS:
American Bar Association Model Canons of Judicial Ethics (C)(1)(c) 10
Wheeler, *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 Va. L. Rev. 269 (1983) 15

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OCTOBER TERM, 1984

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NATIONWIDE MUTUAL INSURANCE COMPANY,

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v.

HENRY GERRARD CLAY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ALABAMA

Nationwide Mutual Insurance Company (hereinafter "Nationwide") petitions for a writ of certiorari to review the judgment and orders of the Supreme Court of Alabama in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Alabama dated February 8, 1985, is unofficially reported at 19 Ala. Bar Rptr. 748, and is reproduced in App. A, *infra* 1a-28a. The orders of the Supreme Court of Alabama dated April 5, 1985, denying rehearing and denying petitioner's Motion for Withdrawal Opinion and Suggestion of Disqualification, are unofficially reported at 19 Ala. Bar Rptr. 1607, and are reproduced in App. B, *infra* 29a-30a. The Circuit Court of Mobile County, Alabama, issued no opinion.

JURISDICTION

The judgment of the Supreme Court of Alabama affirming the $1,296,165.00 trial court judgment against petitioner was entered on February 8, 1985. App. A, *infra* 1a-28a. Nationwide's Application for Rehearing and Motion for Withdrawal of Opinion and Suggestion of Disqualification were denied on April 5, 1985. App. B, *infra* 29a-30a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

This petition for a writ of certiorari is being filed within ninety (90) days from the denial, on April 5, 1985, of petitioner's Application for Rehearing in the Supreme Court of Alabama.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The Ex Post Facto Clause, Art. I, § 10, cl. 1 of the Constitution, provides, in pertinent part, that:

> "No State shall. . .pass any. . .ex post facto law. . . ."

2. The Contract Clause, Art. I, § 10, cl. 1 of the Constitution, provides, in pertinent part, that:

> "No State shall. . .pass any. . .Law impairing the Obligation of Contracts. . . ."

3. The Due Process Clause of the Fifth Amendment of the Constitution provides, in pertinent part, that:

> "[N]or be deprived of life, liberty, or property, without due process of law;"

4. The Excessive Fine Clause of the Eighth Amendment of the Constitution, provides, in pertinent part, that:

> "[N]or [shall] excessive fines [be] imposed. . . ."

5. The Due Process Clause of the Fourteenth Amendment of the Constitution provides, in pertinent part, that:

> "[N]or shall any State deprive any person of. . . property, without due process of law. . . ."

6. The Equal Protection Clause of the Fourteenth Amendment of the Constitution provides, in pertinent part, that:

> "[N]or shall any State. . .deny to any person within its jurisdiction the equal protection of the laws."

7. Section 12-22-72, Code of Alabama (1975), provides, in pertinent part, that:

> "When a judgment. . .is entered. . .for money. . .and the same has been stayed on appeal by execution of bond, with surety, if the appellate court affirms the judgment of the court below, it must also enter judgment against any or all of the obligors on the bond for the amount of the affirmed judgment, 10 percent damages thereon and the costs of the appellate court. . . ."

STATEMENT OF THE CASE

A. Facts Material To The Questions Presented

This action was brought by Henry Gerrard Clay (hereinafter "Clay") against Petitioner Nationwide for bad faith and breach of contract for Nationwide's failure to pay insurance benefits under a contract of disability insurance issued by Nationwide in January, 1977. Clay's claim was submitted to Nationwide on September 26, 1977. At all times material to Nationwide's review of Clay's claim, Alabama did not recognize a cause of action for bad faith failure to pay first party insurance claims. Clay's lawsuit was filed on July 14, 1978, and was still pending on October 2, 1981. On the latter date the Supreme Court of Alabama held, for the first time, that a cause of action for bad faith existed in Alabama. *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1 (Ala. 1981). On the same day *Chavers* was decided, the Supreme Court of Alabama in another decision affirmed a plaintiff's verdict for bad faith but remitted the $1.1 million damage award to $100,000, holding that the award was "obviously the result of passion and prejudice on the part of the jury." *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916, 926 (Ala. 1981).

At trial in December, 1982, Nationwide defended on the theory that Clay misrepresented material facts in his application and that under a prorating provision in the policy he was not entitled to full contract benefits. At the time of trial, the tort of bad faith had been recently defined by the Supreme Court of Alabama as an insurance company's refusal to pay the insured's claim without "a reasonably legitimate or arguable reason for the refusal." *National Sav. Life Ins. Co. v. Dutton*, 419 So.2d 1357, 1362 (Ala. 1982). The trial court held as a matter of law that Clay was not entitled to full contract benefits but nevertheless instructed the jury on the tort of bad faith. The jury returned a verdict for $1,250,000 in punitive damages against Nationwide, for which judgment was entered on December 17, 1982. Including the compensatory award of $46,165.00 on the contract claim, the total judgment against Nationwide was $1,296,165.00. Nationwide's post-trial motion for judgment notwithstanding the verdict, new trial, or remittitur was denied.

On September 13, 1983, Nationwide filed its appellant's brief in the Supreme Court of Alabama. On March 28, 1984, the appeal was orally argued to a five member division of the Supreme Court of Alabama, a member of which was Justice T. Eric Embry. The appeal thereafter was taken under consideration by the entire nine-member Alabama Supreme Court. On February 8, 1985, that court in a 6-3 decision affirmed the trial court's judgment without remittitur. App. A, *infra* 1a-28a. In addition to interest at twelve percent from the date of judgment,[1] a further ten percent affirmance penalty was imposed pursuant to Ala. Code § 12-22-72 (1975). That statute automatically imposes a mandatory penalty of ten percent of any money judgment against an unsuccessful defendant-appellant, but imposes no corresponding penalty on an unsuccessful plaintiff-appellant.

On February 14, 1985, as Nationwide was preparing its application for rehearing, counsel for Nationwide learned for

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[1] *See* Ala. Code § 8-8-10 (1975). *See also*, Ala. R. App. Proc. Rule 37.

the first time that Justice Embry, while this case was *sub judice* in the Supreme Court of Alabama, had filed two civil actions seeking punitive damages against insurance companies based upon the tort of bad faith, which was then being shaped by the Supreme Court of Alabama. Upon obtaining copies of the pleadings in those cases, Nationwide filed a Motion for Withdrawal of Opinion and Suggestion of Disqualification on February 22, 1985, on the ground that Justice Embry had a substantial interest in the rulings of law by the Supreme Court of Alabama in this case. App. C and D, *infra* 31a-64a. Nationwide further asserted that because the other justices participating in the decision of this case were all necessarily affected to some degree by the participation of Justice Embry, the only way to provide a fair and impartial rehearing would be to submit the case de novo to a special court empaneled under the provisions of Ala. Code § 12-2-14 (1975).[2] Simultaneously with that motion, Nationwide filed an application for rehearing raising this and other substantial federal questions. App. E, *infra* 65a-104a.

On March 8, 1985, in a case presently docketed in this court, *Aetna Life Ins. Co. v. Lavoie*, ____ So.2d ____, 19 A.B.R. 272 (Ala. Dec. 8, 1984), *appeal docketed*, 53 U.S.L.W. 3759 (U.S. April 9, 1985) (No. 84-1601) [hereinafter *Aetna v. Lavoie*][3],

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[2]Under this statute, when by reason of disqualification the members of the Supreme Court cannot sit, the Governor of Alabama shall appoint seven members of the state bar to constitute a special supreme court to hear and decide such case. *Cf. Ex parte Alabama Power Co.*, 280 Ala. 586, 196 So.2d 702 (1967). This substitution procedure was simplified in 1973 by a new judicial article of the Alabama Constitution. Alabama Constitutional Amendment No. 328, section 6.10, provides that the Chief Justice of the Supreme Court of Alabama may assign trial or appellate judges (retired or active) "for temporary service in any court." That procedure was followed in *Duncan v. Johnson*, 338 So.2d 1243 (Ala. 1976), when the Chief Justice and all the associate justices recused themselves "because a justice had represented one of the parties to the litigation." *Aetna v. Lavoie*, 19 Ala. Bar Rptr. 1147, 1153 n.1 (Ala. March 8, 1985) (Maddox, J., concurring specially on the disqualification issue), App. F, *infra* 111a.

[3]On June 3, 1985, this Court agreed to hear *Aetna v. Lavoie*, *supra*.

involving nearly identical issues, a similar motion for disqualification was denied by the Supreme Court of Alabama, with three justices concurring specially. On April 5, 1985, the Supreme Court of Alabama denied Nationwide's Motion for Withdrawal of Opinion and Suggestion of Disqualification on the authority of its March 8, 1985, ruling in the *Aetna* case. App. B, *infra* 30a. A copy of that opinion is reproduced herein. App. F, *infra* 105a-113a. In response to Nationwide's application for rehearing, the Supreme Court of Alabama modified its original opinion regarding a particularly objectionable definition of bad faith,[4] but left the judgment otherwise intact. App. B, *infra* 29a-30a.

On May 31, 1985, an Application for Stay of the judgment was granted by Eleventh Circuit Justice Lewis F. Powell, pending the action of this Court on Nationwide's petition for certiorari.

B. How The Federal Questions Were Raised

1. The Disqualification Question

The question pertaining to disqualification of Justice Embry and the other members of the Supreme Court of Alabama was raised below in (a) Nationwide's Motion for Withdrawal of Opinion and Suggestion of Disqualification, App. C, *infra* 31a-62a, (b) the Amendment to Nationwide's Motion for Withdrawal of Opinion, App. D, *infra* 63a-64a, and (c) Nationwide's Application for Rehearing, App. E, *infra* 65a-104a. Those questions were passed upon by the Supreme Court of Alabama in its orders of April 5, 1985, denying both the Motion and the Application. App. B, *infra* 30a.

Nationwide's Motion for Withdrawal of Opinion, and the amendment thereto, asserted rights to due process of law under the United States Constitution (para. 17-19), and con-

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[4]In the original opinion of February 8, 1985, Nationwide was said to be guilty of bad faith due to the ". . . uncooperative, intransigent behavior of the Nationwide agents." That characterization was removed in the court's modification of April 5, 1985. App. B, *infra* 30a.

tended that Justice Embry's participation in the collegial decision rendered the appellate review so unfair that a special court should be appointed to rehear the case as provided under Ala. Code § 12-2-14 (1975). The Supreme Court of Alabama denied Nationwide's motion on the authority of its decision four weeks earlier in *Aetna v. Lavoie*. The Constitutional issues presented in Question 1 were thereby squarely raised and passed upon.

2. Constitutionality Of The Punitive Damage Judgment

a. Question Two was properly raised in the court below.

Nationwide's attack on the $1,250,000 punitive damage judgment as being violative of the Due Process Clause of the Fifth Amendment was raised below in Section IX of Nationwide's Application for Rehearing. App. E, *infra* 91a-92a. Although the Supreme Court of Alabama did not expressly consider this issue, this Court may review it under the general rule that federal questions must have been "*either* raised or squarely considered" in state court. *Illinois v. Gates*, 462 U.S. 213, 76 L.Ed.2d 527, 535 n.1 (1983) (emphasis added). Furthermore, as stated by Aetna Life Insurance Company in its Jurisdictional Statement in *Aetna v. Lavoie*, under Alabama law a party is not precluded from raising a constitutional question for the first time in its application for rehearing. (*Aetna v. Lavoie*, Juris. Stat. at 15)

b. Questions Three and Four are within the scope of Nationwide's attack on the punitive damages judgment and may be raised in this Court.

In its application for rehearing in the Supreme Court of Alabama, Nationwide advanced numerous arguments challenging the validity of the $1,250,000 punitive damages award, App. E, *infra* 65a-93a, although the Excessive Fine Clause and Contract Clause were not cited in those arguments. In *Illinois v. Gates*, 462 U.S. 213 (1983), the United States Supreme Court specifically reserved the question whether the rule concerning an issue "not pressed or passed upon below" is jurisdictional or prudential. 76 L.Ed.2d at 538. The *Gates* court reaffirmed the

statement in *Dewey v. Des Moines*, 173 U.S. 193, 197-98 (1899), that:

> "if the question were only an enlargement of the one mentioned in the assignment of errors, or if it were so connected with it in substance as to form but another ground or reason for alleging the invalidity of the [lower court's] judgment, we should have no hesitation in holding the assignment sufficient to permit the question to be now raised and argued. Parties are not confined here to the same arguments which were advanced in the courts below upon a Federal question there discussed."

Illinois v. Gates, 76 L.Ed.2d at 536. The court in *Gates* further cited two cases that were decided on constitutional grounds not advanced in the state court, *Terminiello v. Chicago*, 337 U.S. 1 (1949), and *Vachon v. New Hampshire*, 414 U.S. 478 (1974). See also *Boynton v. Commonwealth of Virginia*, 364 U.S. 454 (1960), a civil rights case in which a state court conviction was overturned as violative of the Interstate Commerce Act. In *Boynton*, wherein the precise federal question relied upon was not advanced until petitioner's brief on the merits, the Court stated: "We think, however, that the claims of discrimination previously made under the Act are sufficiently closely related to the assignments that were made to be considered within the scope of the issues presented to the State Supreme Court." 364 U.S. at 457.

The rationale for determining whether the contentions are "sufficiently closed related" is explicated in *Hormel v. Helvering*, 312 U.S. 552 (1941): The rule exists "in order that litigants may not be surprised on appeal by final decision there of issues upon which they have had no opportunity to introduce evidence." *Id.* at 556. *See also*, *Singleton v. Wulff*, 428 U.S. 106, 121 (1976). No such impediment is involved here, for the same undisputed facts are the predicate of all the constitutional contentions raised. Since Questions 3 and 4 are only questions of law, not dependent on any further development of facts, no purpose would be served by rigid application of the "not raised below" rule to these questions.

Question 3 pertains to the deterrent effect of the punitive damages sanction on the assertion of nonfrivolous legal defenses, and therefore pertains to the punitive judgment awarded herein. Likewise, Question 4, involving the Excessive Fine Clause and Contract Clause, is simply "an enlargement" of Nationwide's constitutional attack on the $1,250,000 punitive damages award in this case. (See Nationwide's Application for Rehearing, App. E, *infra* 85a-92a) As aptly said in *Illinois v. Gates*, *supra*, it is such "as to form but another ground or reason for alleging the invalidity" of the judgment rendered below. 76 L.Ed.2d at 536.

3. Constitutionality Of Ala. Code § 12-22-72 (1975)

Question 5, involving the constitutionality of the ten percent affirmance penalty automatically imposed on defendant-appellants under Ala. Code § 12-22-72 (1975), has been seasonably raised herein. By its own terms, that penalty affects a specific litigant only upon the event of the appellate court's decision. Until the appellate decision is rendered, and rehearing is denied, the penalty's incidence is hypothetical. The Supreme Court of Alabama rejected Aetna's challenge to Ala. Code § 12-22-72 while Nationwide's application for rehearing was still pending. Hence, any effort by Nationwide to raise the question at that stage would have been futile. In these circumstances there is no practical purpose in requiring that Nationwide have attacked the penalty on constitutional grounds in the court below.

In any event, should Ala. Code § 12-22-72 be declared unconstitutional in *Aetna v. Lavoie*, it would be manifestly unjust to allow that unconstitutional statute to penalize Nationwide. This Court has previously exercised discretion to prevent such manifest injustice. *See Singleton v. Wulff*, 428 U.S. at 121; *Hormel v. Helvering*, 312 U.S. at 557.

C. Reasons For Granting The Writ

1. The Disqualification Issue

It is settled constitutional law that a judge may not participate in deciding a case in which he has a substantial financial

interest. *Gibson v. Berryhill*, 411 U.S. 564, 579 (1973); *Ward v. Village of Monroeville*, 409 U.S. 57, 60-63 (1972); *Tumey v. Ohio*, 273 U.S. 510, 532 (1927). The right to a fair and impartial decisionmaker has been consistently upheld by this Court. *See Withrow v. Larkin*, 421 U.S. 35, 46-47 (1975); *In Re Murchison*, 349 U.S. 133, 136 (1955); *Tumey v. Ohio*, 273 U.S. at 532. In *Tumey*, the Court stated:

> [T]he requirement of due process of law in judicial procedure is not satisfied by the argument that men of the highest honor and the greatest self-sacrifice could carry it on without danger of injustice. Every procedure which would offer a possible temptation to the average man as a judge to forget the burden of proof required to convict the defendant, or which might lead him not to hold the balance nice, clear and true between the state and the accused denies the latter of due process of law.

Tumey v. Ohio, 273 U.S. at 532.[5] The standard articulated in *Tumey* is reflected in generally accepted canons of judicial conduct. Canon C(1)(c) of the American Bar Association Model Code of Judicial Conduct, in force in Alabama as well as in most other states and in the federal court system, provides that a judge should disqualify himself in a proceeding in which his impartiality might reasonably be questioned, including instances in which the judge has "a financial interest in the subject matter in controversy . . . or any other interest that could be substantially affected by the outcome of the proceeding."

a. The Financial Interest of Justice Embry required his recusal.

According to these standards, Justice Embry had a substantial financial interest in the case at bar—an interest in both the expansion of the tort of bad faith and the affirmation of large

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[5]*See Gibson v. Berryhill, supra*, wherein the Court held "the financial stake need not be as direct or positive as it appeared to be *Tumey*." 411 U.S. at 579.

punitive damages awards in such bad faith cases. Justice Embry authored the 5-4 majority opinion in *Aetna v. Lavoie*, affirming a $3.5 million punitive damages award, and two months later joined the 6-3 majority in the affirmation of the $1,250,000 punitive damages bad faith judgment in this case. In so doing, Justice Embry directly participated in determining the standards by which his own million dollar bad faith action will be decided.[6] These facts alone present a substantial constitutional question of such importance as to justify resolution by this Court under 28 U.S.C. § 1257(3). By reason of Justice Embry's substantial interest in the case, his disqualification was required on his own motion or, failing such self-recusal, by action of the Supreme Court of Alabama as a body.

Whether a motion for disqualification of an appellate judge should be decided by that judge individually, or by the court as a body, has yielded a split of authority among the states. Some jurisdictions hold that disqualification is an individual matter. *See State ex rel. Wild v. Otis*, 257 N.W.2d 361 (Minn. 1977); *Aetna v. Lavoie, supra*. There is a strong contrary view. *See State ex rel. Short v. Martin*, 256 P. 681 (Okla. 1927). *See also, State ex rel. Mitchell v. Sage Stores Co.*, 157 Kan. 622, 143 P.2d 652 (1943). However, none of those cases involved an appellate judge with a substantial financial interest in the outcome.[7] Futhermore, no decision suggests an appellant is remediless if an appellate judge, and the court on which he sits, declines to exercise the responsibility of recusal in a case wherein recusal is required under Constitutional standards.

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[6]The substantial financial interest of Justice Embry is manifest in the obvious fact that the settlement value of Justice Embry's action against Blue Cross/Blue Shield of Alabama, App. C, *infra* 46a-56a, has been enhanced by the two decisions of the Supreme Court of Alabama in *Aetna v. Lavoie* and the instant case.

[7]Likewise, *Laird v. Tatum*, 409 U.S. 824 (1972) (Mem. Op. of Rehnquist, J.) involved only an alleged philosophical interest, not a financial interest.

b. Justice Embry's Participation Infected the Entire Alabama Supreme Court with Unconstitutional Bias.

Members of a collegial bench committing themselves to a decision in the face of known bias in their composition may not thereafter decide the same matter, at least if an adequate alternative remedy is available. All the judges participating in a collegial decision, if they engage in the exchange of views called for by the nature of their office, take account of the views of each participating judge. Such collegial interaction is particularly significant where the case involves a cause of action still being shaped by the court. In the present case, Justice Embry's participation in the decision-making process may be deemed to have infected the entire Alabama Supreme Court with some level of unconstitutional bias.

Where there is such disqualification that a quorum cannot be constituted, there is a readily available mechanism provided under Alabama state law. As discussed at page 5, *supra*, there are two alternative procedures whereby a special supreme court may be constituted to decide an appeal. Such a tribunal may be established under Ala. Code § 12-2-14 (1975). That procedure was followed in *Ex parte Alabama Power Co.*, 280 Ala. 586, 196 So.2d 702 (1967), when all the justices recused themselves because the plaintiff was a justice of the Supreme Court of Alabama. An even simpler procedure is available under a 1973 amendment to the Alabama Constitution, which enables the chief justice to assign appellate or trial judges, active or retired, "for temporary service in any court." Alabama Constitution, Amendment 328, Section 6.10. That procedure was utilized in *Duncan v. Johnson*, 338 So.2d 1243 (Ala. 1976), when all the justices of the Alabama Supreme Court recused themselves because one of the justices "had represented one of the parties to the litigation." *Aetna v. Lavoie*, 19 Ala. Bar Rptr. 1147, 1153 n.1 (Ala. March 8, 1985) (Maddox, J., concurring specially on the disqualification issue), App. F, *infra* 111a.

In *Ex parte Alabama Power Co.*, *supra*, and *Duncan v. Johnson*, *supra*, all the justices of the Supreme Court of Ala-

bama recused themselves where only one of their number was disqualified for imputed bias under state law. In this case, however, the Supreme Court of Alabama declined to use that available procedure to vindicate a standard of imputed bias established by the Constitution. The state law remedy should be available for a federal as well as a state ground of recusal. In his specially concurring opinion on the disqualification motion in *Aetna v. Lavoie*, the Chief Justice of the Supreme Court of Alabama described Aetna's motion as a "serious charge impugning the honesty and integrity of the Alabama Supreme Court and its members." App. F, *infra* 107a. The court's opinion in that case was in turn cited in the court's denial of Nationwide's similar motion. App. B, *infra* 30a. Under these circumstances a fully fair and unbiased rehearing by Justice Embry's fellow justices does not seem possible.[*] The principle involved is analogous to cases in which a judge who has cited a party for contempt is disqualified from presiding at the contempt hearing. *See Mayberry v. Pennsylvania*, 400 U.S. 455 (1971); *Offutt v. United States*, 348 U.S. 11 (1954); *In re Neiswinger*, 467 N.E.2d 43 (Ind. App. 1984).

2. The Issue Of Fair Warning Of Punitive Sanction

This Court has held that the Ex Post Facto Clause limits only the powers of the legislature and not those of the judicial branch of government. *See Frank v. Mangum*, 237 U.S. 309 (1915). However, the policy reflected in the Ex Post Facto Clause is "fundamental to our concept of liberty." *Marks v. United States*, 430 U.S. 188, 191 (1977). Persons have a constitutional right to fair warning of conduct that will give rise to punishment, a right that is protected against judicial infringe-

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[*] By requesting disqualification of the entire court below, Nationwide does not suggest that the Supreme Court of Alabama and its members are lacking integrity. Nationwide simply suggests that Justice Embry's influence arguably had some effect on the other judges' attitudes toward the insurance company's conduct in this case. Several of the judges' attitudes toward the tort of bad faith have dramatically changed within a few months. The attention of this Court is respectfully directed to paragraphs 4 through 9 and Exhibit C to Nationwide's disqualification motion. App. C, *infra* 33a-35a.

ment by the Due Process Clause of the Fifth Amendment. *Id.* at 192. In *Marks*, *supra*, this Court observed that an unforeseeable judicial enlargement of a criminal statute, applied retroactively, operates precisely like an ex post facto law. *Id.* If a state legislature is barred by the Ex Post Facto Clause from passing retroactive laws, "it must follow that a state supreme court is barred by the Due Process Clause from achieving precisely the same result by judicial construction." *Id. Marks* involved the judicial enlargement of a quasi-criminal statute, but its rationale applies with equal force to the retroactive recognition of a common law cause of action providing for punishment by punitive damages.

The punitive damage award assessed against Nationwide in the present case was based on a legal standard adopted several years after the fact of the conduct in question. Throughout the submission of Clay's claim to Nationwide in 1978, Alabama did not recognize the tort of bad faith. There was still no tort of bad faith when suit was filed on July 14, 1978. On May 5, 1981, the Alabama legislature enacted a statute giving a policyholder, whose claim had been invalidly denied, a right of action against the insured for the overdue benefits plus an interest penalty of 1.5 percent per month. Ala. Code § 27-1-18 (1975). Since the Supreme Court of Alabama has held that such statutes may not apply retroactively, *see Tyson v. Johns-Manville Sales Corp.*, 399 So.2d 263, 269 (Ala. 1981); *City of Brewton v. White's Auto Store*, 362 So.2d 226, 227 (Ala. 1978), the right of action created under Ala. Code § 27-1-18 could not have been asserted retroactively against Nationwide. The Supreme Court of Alabama, however, has undertaken what the legislature could not, by creating a new legal standard, upon pain of substantial punitive damages, after the fact of the conduct sought to be redressed.

3. The Issue Of Chilling The Assertion Of Legal Rights.

In addition to violating Nationwide's due process right to fair warning of punishable conduct, the imposition of punitive damages for asserting nonfrivolous legal and factual defenses infringes Nationwide's right of access to court and of seeking

assistance of counsel. The insured's claim in this case was, as a matter of law, at least partially debatable. One of Nationwide's defenses was that the insured was not entitled to full contract benefits under a prorating provision in the policy. Clay disputed this defense, contending he was entitled to full benefits. The trial court computed Clay's compensatory award under the contract by giving effect to the prorating provision asserted by Nationwide as a defense. The jury was nevertheless permitted to award $1,250,000 in punitive damages.

Imposing punitive damages in such circumstances substantially deters and thereby infringes the due process right of a party in a legal dispute to have access to court and to seek assistance of counsel in a matter where the party has a non-frivolous defense. The effect of punitive damages as imposed in this case is that a party must forego a valid legal defense if the monetary value of that defense is exceeded by the amount at risk in punitive damages. Since the punitive liability can exceed $1 million, and did so in this case, the rule applied herein virtually precluded assertion of any legal defense that was not certain to be sustained.

This Court has recognized that punitive damages may not be so imposed as to chill exercise of First Amendment rights to free speech. *See New York Times v. Sullivan*, 376 U.S. 254 (1964). The same principle should be applied to exercise of the right of access to court and to assistance of legal counsel. The Due Process Clause protects "civil litigants who seek recourse in the courts, either as defendants hoping to protect their property or as plaintiffs attempting to redress grievances." *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 429 (1982). This includes "the opportunity to present his case and have its merits fully judged." *Id.* at 433. *See also*, Wheeler, *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 Va. L. Rev. 269, 277 (1983).

4. The Excessive Fine Clause And Contract Clause Issues.

The Excessive Fine Clause of the Eighth Amendment as applied to the states under the Due Process Clause of the

Fourteenth Amendment, *Furman v. Georgia*, 408 U.S. 238 (1972), affords additional federal constitutional protections against the $1,250,000 punitive damages award imposed upon Nationwide. The fundamental purpose behind that clause is to protect defendants from excessive pecuniary sanctions, whether characterized as criminal or civil. There is no reason in principle why it should not apply in civil cases wherein punishment takes the form of money damages.

The question whether a state court can retroactively expand the duties expressed in a contract of insurance, and impose severe punitive damages for any breach thereof, is a question of first impression in this Court. However, it is not dissimilar to the issues presented in *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, *reh. denied*, 99 S.Ct. 233 (1978), wherein this Court struck down a state statute that retroactively imposed on Allied Steel a duty to increase payments under an employee pension plan contract. No material distinction should exist between obligations legislatively created and those judicially created that retroactively alter the terms of a contract, especially when a breach of the expanded terms is held punishable by extracontractual punitive damages. The $1,250,000 punitive damages award against Nationwide is an unconstitutional impairment of private contractual obligations in violation of the Contract Clause.

The issues involving the Excessive Fine Clause and the Contract Clause, as developed by Aetna in its jurisdictional statement, are adopted herein. *See Aetna v. Lavoie*; No. 84-1601.

5. The Unconstitutionality Of Ala. Code § 12-22-72 (1975).

A further substantial constitutional question is whether Ala. Code § 12-22-72 (1975), violates a defendant-appellant's rights under the Equal Protection Clause of the Fourteenth Amendment. That statute imposes a penalty of 10% of a money judgment against any defendant who appeals unsuccessfully to the Supreme Court of Alabama. No similar penalty is imposed on a

plaintiff who appeals unsuccessfully. In the instant case, the penalty alone amounts to $129,616.50, which is in addition to interest at the rate of 12% from entry of judgment in the trial court. *See* note 1 *supra.*

The Equal Protection Clause of the Fourteenth Amendment applies fully to the rights of a party seeking review in the state appellate courts, *Cf. Evitts v. Lucey*, 469 U.S. ____, 105 S.Ct. 830, *reh. denied*, 105 S.Ct. 1783 (1985), and renders invalid any state statute that draws irrational distinctions between plaintiff-appellants and defendant-appellants. *Cf. Lindsey v. Normet*, 405 U.S. 56 (1972). In *Lindsey v. Normet, supra*, the Court stated that "a state may act to discourage patently insubstantial appeals, if [its] rules are reasonably tailored to achieve these ends and if they are uniformly and nondiscriminatorily applied." 405 U.S. at 78. The state statute challenged herein automatically penalizes a defendant-appellant who unsuccessfully asserts nonfrivolous grounds for appellate relief, but imposes no corresponding penalty on a plaintiff. Such a rule in its own terms is discriminatory and is "reasonably tailored" only to an impermissible end, that of discriminating between a party who initiates litigation as a plaintiff and one who responds to it as a defendant. Accordingly, Nationwide submits that the $129,616.50 affirmance penalty in this case infringes upon its right to equal protection under the Due Process Clause of the Fourteenth Amendment.

CONCLUSION

In view of the foregoing, and the fact that the Court has already agreed to hear the similar case of *Aetna v. Lavoie*, *supra*, the writ of certiorari should issue. Consideration of this case with *Aetna v. Lavoie* will enable the Court to have the benefit of a more complete development of the issues common to these cases.[9]

Respectfully submitted,

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[9]Since the issues in this case and *Aetna v. Lavoie* are substantially similar, it would seem inappropriate for relief to be granted in one case and not the other. Avoidance of the possibility of disparate results is another reason the writ of certiorari should be granted.

APPENDIX

TABLE OF CONTENTS
APPENDIX

A. *Nationwide Mutual Insurance Co.* v. *Clay*, ____ So.2d ____ (Ala. Feb. 8, 1985) 1a

B. *Nationwide Mutual Insurance Co.* v. *Clay*, ____ So.2d ____ (Ala. April 5, 1985) 29a

C. Motion For Withdrawal Of Opinions and Suggestion Of Disqualification 31a

D. Amendment to Motion For Withdrawal Of Opinions and Suggestion of Disqualification 63a

E. Application For Rehearing 65a

F. *Aetna Life Insurance Co.* v. *Lavoie*, ____ So.2d ____ (Ala. March 8, 1985) 105a

APPENDIX A

THE STATE OF ALABAMA
JUDICIAL DEPARTMENT
THE SUPREME COURT OF ALABAMA
October Term, 1984-85

82-536 & 82-917

Filed
February 8, 1985
Clerk
SUPREME COURT OF ALABAMA

Nationwide Mutual Insurance Co.

v.

Henry Gerrard Clay

Appeals from Mobile Circuit Court

Almon, Justice.

These consolidated appeals involve a claim for bad faith failure to pay a claim on a disability insurance policy. At trial, the court granted a directed verdict for the plaintiff insured in the amount of $46,165.00 on the contract count. The jury returned a verdict for the plaintiff in the amount of $1,250,000.00 on the bad faith count. The trial court denied the defendant insurance company's post-trial motions, and the company appeals.

FACTS

Because the issues turn on fact questions, we include the following detailed statement of facts. The facts are supported largely by the numerous exhibits, including memoranda of

conversations from Nationwide's file on Clay's claim. Clay also kept notes of his telephone conversations and while testifying used them to refresh his memory.

Henry Gerrard Clay applied for a policy of disability insurance with Nationwide Mutual Insurance Company on December 8, 1976. Clay was a practicing attorney in Mobile, and he applied for this policy at the instigation of his friend Bill McDowell, who had previously sold him a hospitalization insurance policy with Nationwide. McDowell filled out the application as Clay gave him the information required.

Two answers on the application later gave rise to charges by Nationwide of misrepresentation: To the question, "What is your average earned monthly income?" Clay answered, "$1,800." To the question, "Will the insurance applied for replace existing Disability Income Insurance . . . owned by applicant?" Clay answered, "Yes," and stated the company and amount as "Paul Revere $400/month."

Clay went to the office of Dr. Herbert Allen on December 14, 1976, for a physical examination. Clay testified that he did not remember seeing the doctor, but thought he had only seen a nurse, who took a blood sample and some measurements. The report indicates Clay was having no problems with his eyes. Clay's disability giving rise to the instant lawsuit was cataracts, which were diagnosed on August 29, 1977.

Nationwide issued the disability income policy effective January 19, 1977, but because McDowell told the underwriting department that Clay should be rated a Class AAA risk instead of a Class A risk, the policy was not sent to Clay until this change was made and did not reach him until March.

In the meantime, Clay had called Paul Revere Insurance Company to cancel the disability policy he had with that company. A Paul Revere agent, Leon Adams, called on Clay to ask why he had cancelled his policy. Clay told Adams that he intended to buy a disability policy with Nationwide. Adams compared the Paul Revere contract with the Nationwide con-

tract and offered Clay increased coverage with Paul Revere. As Adams testified, "I talked him into getting a lot more coverage." On February 4, 1977, Clay applied for disability insurance with Paul Revere in the amount of $2200 per month and a policy was issued on February 26. When he received the Nationwide policy in March, he tried to cancel it, but could not reach McDowell, who had been promoted. Clay allowed both policies to remain in effect, with the premiums being paid on a monthly bank draft.

On April 29, 1977, Clay visited Dr. Charles Ivey Williamson for a checkup, complaining that he had had fever recently and was feeling tired and run down. Dr. Williamson conducted lab tests, which showed a possibility of a viral infection affecting Clay's liver, but nothing seriously abnormal. Dr. Williamson recommended a diet and rest. His records indicated that Clay did not complain to him at this time of eye problems.

Clay continued to run a fever and feel sick through the spring and summer. On August 29, he went to Dr. Edwin A. Ross, his optometrist, with whom he had regular checkups. Dr. Ross diagnosed cataracts, which had caused his vision to drop from 20/20 in each eye to 20/40 in the left eye and 20/50 in the right. Dr. Ross testified that Clay's cataracts were in such a position that they caused a severe loss of vision and could not be corrected with glasses. He also testified that the cataracts developed in a short period of time, unlike in older people[1] where they cause a gradual loss of vision. Dr. Ross recommended that Clay see an ophthalmologist. On September 7, 1977, Clay saw Dr. James M. Harrison, who confirmed that Clay had cataracts.

Clay closed his law office, referred his clients with active files to other attorneys, and stored his books, office equipment, and other items in a warehouse. On September 26, 1977, Clay filled out a disability claim to file with Nationwide. He stated that the symptoms first appeared "July, 1977 to August, 1977." Clay left blank the spaces on the form for "Monthly income" and

---

[1]Clay was 38 when his cataracts developed.

"any other Companies with whom you may carry Accident & Sickness insurance." Dr. Harrison completed the attending physician's portion of the form, indicating that Clay was totally disabled from September 7, 1977, "until recovered from surgery," and that the symptoms appeared "gradually."

Nationwide received the claim form at its group claims office in Atlanta on October 3. That office forwarded the form to Nationwide's office in Columbus, Ohio, where it arrived on October 13, 1977. The claim was assigned to Jim Otey, a medical claims examiner, on October 20. On November 10, Clay called to inquire about the status of his claim and requested a reply by telephone. On November 11, he called again. The message in Nationwide's file on Clay's claim includes the notation, "Please Call Today." Nationwide did not return either call.

Clay telephoned twice on November 14, and talked to Otey. Clay testified that when he first called, Otey refused to find his file, saying, in Clay's words, "if he started doing it for me he would have to talk to anybody that had a claim anytime they wanted to talk to him." Otey denied that he ever refused to look for Clay's file. Clay testified that during this first conversation Otey told him he had seen the file, whereupon Clay asked if Nationwide was going to pay. Clay testified that Otey answered,

> "'Naw, no decision's been made on it yet." He said, 'but I,' he said, 'I can tell you right now' and he said, 'cataracts are not a disability. They take at least two years to become disabling.' And he said, his exact words, he said, 'there's no way I could be disabled with cataracts.'"

Clay called Otey again on the afternoon of November 14, at which time Clay mentioned to Otey that Dr. Ross had first diagnosed his cataracts. Otey responded that Dr. Ross, instead of Dr. Harrison, would have to file the attending physician's report. Someone at Nationwide had initially told Clay that he should have Dr. Harrison fill out the claim form because Dr. Harrison was a medical doctor and Dr. Ross was not. Otey told

Clay that the doctor who originally discovered the cataracts would have to send a statement.

Otey examined the file in detail on November 15. He was concerned whether Clay's cataracts existed prior to the policy coverage, although he had seen the report from Dr. Allen showing Clay had no eye problems on December 14, 1976. Otey had Equifax Services arrange for another doctor to examine Clay. Dr. Dan Rencher, an ophthalmologist, examined Clay on November 21, and sent a report to Equifax on November 23. Dr. Ross also sent a form to Nationwide on November 23 giving his diagnosis of cataracts.

Dr. Rencher's report stated:

> "In my professional opinion there is in Mr. Clay's case the presence of some disability in that he is an attorney at law which necessitates that he read a considerable amount and he is experiencing difficulty doing so. It is my opinion that this disability is due solely to the cataracts.

Dr. Ross's report included the following;

(2A) When did symptoms first appear or accident happen?	Date prior to Aug 29 19 77
(B) When did patient first consult you for this condition?	Date Aug 29, 19 77
(C) Has patient ever had same or similar condition? If "Yes" state when and describe	Yes ☐ No ☒

Neither of these reports clarified whether Clay's cataracts developed prior to the effective date of the coverage. Nationwide received Dr. Ross's report on December 1, 1977, but did not receive Dr. Rencher's report from Equifax until December 16. Otey denied to Clay that Dr. Rencher's report had been received, and later Equifax obtained another report, which stated that in Dr. Rencher's opinion Clay's "visual acuity constitutes a disability in his work as an attorney at law." Nationwide received this copy on January 4, 1978.

Other activity concerning Clay's file continued while these doctors' reports were proceeding. Bill McDowell, who had

transferred to Nationwide's office in Birmingham since selling Clay his policy, testified that he saw Clay around Thanksgiving and that at that time Clay's vision was poor and he was keeping the house dark. McDowell talked to Otey on the telephone on November 30, 1977, and said Clay thought Nationwide was "trying to pull something." Otey denied at trial that McDowell had relayed this message, but his notes on the conversation mention it, including the language just quoted. The notes also state that Otey "*assured*" (Otey's emphasis) McDowell "we had not even thought in that way. Just routine handling as all cataracts were contestable. Exam was 11/21 and we should be getting report soon." Otey's notes conclude with an indication that McDowell responded "OK—carry on."

Clay talked to McDowell on December 2. He testified that McDowell said Otey would pay only when Clay set a date for an operation. Clay then telephoned Otey, who denied that he was waiting for an operation date and said that he was waiting for the report from Dr. Rencher. Clay said he would call Dr. Rencher to help speed up the report.

Clay telephoned McDowell again on December 5, at which time, as he testified, McDowell told him Otey thought he was working and concealing income and had "made his own disability." When Clay called Otey to ask what he meant, Otey would not discuss it. Clay asked to talk to Otey's superior, but Otey said there was no one else he could talk to except in the legal department.

Clay talked to Otey and McDowell several more times, including once on December 21, when Otey stated that he was still waiting for Dr. Rencher's report, but would not get the file. As noted above, Nationwide stamped Dr. Rencher's report "received" on December 16. Otey testified that Equifax, in forwarding the report, had not included the claim number, so placing it in the proper file took longer. Clay told Otey that Nationwide had selected Dr. Rencher, Clay had kept his appointment, Dr. Rencher had sent the report a month earlier, and Nationwide was making no effort to investigate.

Clay also complained that Nationwide was still deducting premiums from his checking account even though the policy had a waiver of premiums provision. Otey responded that the premiums would have to continue until he was satisfied of total disability and that company policy was that any premiums that should have been waived would be refunded later.

During this December 21 conversation, Clay continued to request that Otey get the file. Otey suggested that if Clay could give him the claim number, he might be able to retrieve the file. Clay sorted through his papers and, using a magnifying glass, read the claim number to Otey. Clay testified that Otey responded, "Well, that proves you can read and we don't owe you any disability," and accused him of concealing income.

Otey also asked Clay if he had any other insurance. Clay's testimony about this exchange includes the following;

> "I said, 'listen you have had this claim here for three months to do it,' and I said, 'listed on the application is a Paul Revere policy.' I said, 'have you even called them or telephoned 'em or written any letters to find out about that Paul Revere policy?' He said, 'no, I'm talking about other policies. Something where you're concealing from us.' I said, 'well, the only thing—' I said, 'I've got a little thing, insurance thing that I sent for the mortgage payments on my house.'
>
> ". . . And he said, 'I know about that.' His exact words, says, 'I know about Paul Revere and the mortgage insurance with American Home.' He said, 'do you mean to tell me you have no other disability insurance other than Paul Revere and American Home Mortgage Insurance?' I said, 'that's right. I have no other insurance other than that; no other disability income insurance.'
>
> "Q Did you have any other, please, sir
>
> "A No. No other disability income insurance. But I knew in the back of my mind that he didn't understand, that he was being a little bit misled but he was misleading

himself. This is—Three months had gone by and he hadn't even looked at the file other than to make accusations on the telephone."

On December 30, Clay called Otey, who said the claim had been turned over to the legal department. Around this time, Otey took the file to John Harker, claims attorney for Nationwide. On January 13, 1978, Harker and Otey requested Nationwide's in-house doctor to review Clay's doctors' reports—the file now included Dr. Harrison's report, Dr. Ross's report, and the two reports from Dr. Rencher—and answer the question, "Noting the degree of sight he has in each eye, would an individual of this occupation be totally disabled?" The doctor returned the form on the same day with the notation, "Not completely and totally unable to peform his usual and customary occupation." Otey mentioned to Harker the probability of other insurance being involved. He testified that taking the claim to Harker effectively terminated his active involvement in handling the file.

On January 11, 1978, O.B. Carr, an insurance investigator with the Alabama Department of Insurance, sent a letter to Nationwide, which reads: "Please advise this department relative to disposition of referenced claim. Mr. Clay alleges to have been continuously totally disabled since September 7, 1977." Nationwide received this letter on January 16.

Also on January 16, Harker wrote Clay stating that Nationwide would not pay the claim. Harker testified that he disagreed with the in-house doctor's conclusion and believed Clay was totally disabled from practicing law. He based the denial of coverage on his conclusion that Clay's cataracts pre-existed the effective date of coverage. Harker's letter stated that Dr. Ross's report "indicates that although he did not treat you until August 29, 1977, symptoms of your condition began prior to 1977."(See the portion of Dr. Ross's report duplicated above.) The letter concluded with a statement that Nationwide would be "more than happy to review" any additional information from Clay and reconsider the claim.

Clay telephoned Harker on January 11, 17, and 18, but was told Harker was not in. He reached Harker on the morning of January 19th before receiving his mail. Harker told him of the letter tentatively denying coverage due to pre-existence of cataract symptoms. After Clay received the letter in the mail later that day, he called Harker back and accused him of intentionally misreading Dr. Ross's report. Harker told Clay he would immediately send a payment for one month's benefits and approve payment on the claim as soon as Dr. Ross confirmed that Clay did not have catracts prior to 1977. Clay testified that he did not receive his first check until February 13.

In his notes on the conversation, Harker included a note to have Equifax inquire whether Clay had any other policies. In conducting an investigation, Equifax learned that Clay had not filed income tax returns for 1975, 1976, or 1977. Nationwide also learned that Clay had a $2200 Paul Revere policy that was a "make over" of the policy mentioned on Clay's application with Nationwide. Clay testified that he talked to Harker on January 31, 1978, and Harker said that if the Paul Revere policy was issued after the Nationwide policy, it wouldn't affect Clay's coverage with Nationwide, but that "they [Nationwide] would pay full coverage." Harker later received a letter from Paul Revere stating that their policy was a "new policy" issued in February 1977 as a make-over of his 1966 policy. When he talked to Clay on February 20, he said, according to Clay, that the Nationwide policy had been issued first. Based on this information, Clay agreed with Paul Revere to reduce his coverage from $2200 per month to $1250 per month with a one-year additional benefit of $150 per month.

During this period, the question of the onset of Clay's disability was settled to Harker's satisfaction. He did not talk to Dr. Ross the day after the January 19 conversation with Clay, but wrote a letter to Dr. Ross on February 7 asking for the date the cataracts appeared. Dr. Ross replied that there had been nothing abnormal when he had examined Clay on November 3, 1976, and no sign of "any significant impairment of visual

acuity—until the exam of August 29, 1977."Harker had instructed Otey to request "continuation of disability" statements from Clay and Dr. Ross and include these forms with the check authorized on January 19, which Clay received on February 13. When Harker received the letter from Dr. Ross on February 23, he sent it to Otey with instructions to pay Clay's sickness disability income. Otey noticed that the "continuation of disability" forms were not in the file, initialed Dr. Ross's letter with a notation "Forms out," and held up the benefits.

On February 28, Nationwide received another letter from O.B. Carr of the Alabama Department of Insurance, referring to the unanswered January 11 letter and requesting Nationwide to advise the department as to the present status of Clay's claim. Harker responded on March 7, stating that he was unable to determine if Nationwide had received the first letter. He recited the history of Clay's application, claim, and the treatment thereof. The letter concluded. "At this time, we are awaiting only return of claim forms from Mr. Clay indicating disability and dates of treatment through the present. Immediately upon receipt of that information, we will be in a position to bring Mr. Clay's disability payments up to date."

When Clay received a copy of this letter on March 9, he called Harker and said there was a lot in the letter that was not true, particularly the statement that Nationwide was merely awaiting forms from Clay. Clay testified that the forms were not inclosed with the check. He said he complained to Harker, "[I]t's been one series of promises after another and you've never said anything about waiting on anything from me . . . [E]very time that you say you'll pay as soon as you get a medical report you don't pay." Clay threatened to have the insurance department investigate or to sue, whereupon Harker said, according to Clay, "[I]f you file suit, you won't get a nickel for at least ten years."

Harker offered to send another one-month "good faith" payment of $1300, and Clay responded, "[A]bsolutely not . . . either pay it up or deny the claim." Harker agreed to pay the

benefits current to February 1, and Clay agreed to return a current medical report if Harker sent him a form along with the payment. Harker's notes on this conversation read:

> "Pay another payment to Feb. 1, 1978. He will send forms. I don't believe we can justify a delay since his condition could not improve without surgery. Also suggest we send Equifax now to investigate if office is open."

An Equifax agent asked Clay on March 15 to release his income tax returns, which Clay refused to do. The agent called Otey to tell him this, and that Clay apparently had not filed a return for 1976. Also on March 15, Dr. Ross completed the continuation of disability forms and sent them to Nationwide. They were received on March 21.

On March 28, Harker wrote Clay:

> "In investigating a claim which you have against the above indicated policy, it has come to our attention that there may be certain information which was withheld from us on the application; information which was necessary in determining the amount of disability insurance for which you would have been eligible under our company rules.
>
> "Based on that fact, I find that we will need some proof of the income which you represented on your application in December, 1976. That is, at that time, you indicated you were averaging $1,800 per month. Information has come to our attention that you were making far less than that and as such, we will need proof of income.
>
> "Although, as I am sure you are aware, you have no duty to provide us with income tax records[, a] copy of your tax return would effectively close the matter. Any other information you can provide showing income would be quite beneficial."

Harker testified that if Clay had not filed income tax returns, "there was a strong possibility in my mind that he had had no

income. . . . If his income was less, it would have affected the policy as well based on the other insurance that he had."

Clay testified that when he received this letter he called Harker and told him:

> "I thought the only reason he'd asked for that is because Bill McDowell had told him I didn't have tax returns but that I did have . . . that I kept good records in my office and I said it'd be fairly easy for me to verify my income for 1976 but . . . I did not believe him when he said it would close the matter. . . . I said, if there's anything that's come to your attention that's new and you have a reason to ask for the tax return, . . . I will try to verify my income during 1976 just like you said. But, I said, without that, . . . it's unreasonable for you to ask for it at this point; you've had six months to investigate it."

His testimony continued:

> "Q What did he say, please?
>
> "A Well he said that the company had discussed it and that was the position they were gonna take . . . [b]ut he said he didn't think that he had to tell me the details of his investigation. So he wouldn't tell me why he wanted the income tax return."

On April 5, O.B. Carr again wrote Harker, stating that "Obviously, Mr. Clay is concerned over your change of plan." Harker wrote back, asking Carr to help Nationwide to persuade Clay to submit his income tax returns. Clay filed this suit on July 14, 1978.

PROCEEDINGS BELOW

Clay's original complaint, filed on July 14, 1978, sought damages in the amount of $100,000 for breach of contract. Nationwide answered with a general denial of the allegations of breach, stating that "at this time it has still not completed its investigation." Nationwide included with its answer a request for production of Clay's federal and state income tax returns

and his hospital, doctor, and medical reports. When Clay did not respond, Nationwide filed a motion for the court to compel Clay to produce the documents. The court granted this motion on February 8, 1979, giving Clay 20 days to comply. When he did not, Nationwide filed on March 6 a motion styled "Motion for Default Judgment," which we take to be a motion to dismiss pursuant to Rule 37(b)(C), A. R. Civ. P.

In response to this motion, Clay stated that he had not filed income tax returns for the years in question. He gave a deposition concerning these matters on May 30, 1979. The case was continued several times, and in March 1980, Clay's original counsel withdrew and his present counsel entered an appearance. The parties conducted further discovery and the court granted continuances until, on April 29, 1981, Clay filed his first amended complaint.

The amended complaint included three counts: one for bad faith "in failing and refusing to pay the plaintiff the benefits due under such policy and in continuing to require and accepting premiums for said policy;" a second count for fraud; and a third count for breach of contract. The first two counts each sought $1,500,000 in damages, and the third sought $150,000. This amendment came shortly after this Court recognized a cause of action against insurers for bad faith failure to pay a claim in *Chavers v. National Security Fire & Cas. Co.*, 405 So. 2d 1 (Ala. 1981).

Nationwide sought discovery from Clay of documentation of Clay's income for 1970 through 1980. On May 8, 1981, Nationwide filed a motion to compel Clay to respond to these discovery requests. On January 28, 1982, Clay filed a motion to limit discovery. The court on February 5 granted the motion "to the extent that the Plaintiff shall at this time produce to the Defendant the amount of deposits to his attorney accounts during the period in question." Clay supplied a listing of deposits for the years 1969 through 1976. Approximately two weeks before trial, Clay provided records of his bank deposits for January through September of 1977.

On February 22, 1982, Clay filed a second amended complaint, which corrected some of the factual allegations. Nationwide filed an answer to this amended complaint (it had not answered the first amended complaint), denying that it had acted in bad faith and stating that it received information in March 1978 which prevented the previously anticipated resolution of the claim. Clay filed a third amended complaint on April 23, 1982, amending the *ad damnum* clauses of each count to claim $3,000,000.

Nationwide's answer to the third amended complaint added defenses that Clay's earnings were insufficient to provide the benefits provided in the policy; that any benefits due were to be prorated with Clay's other disability income policies; that Clay had misrepresented his income in obtaining the policy; that, to obtain the Nationwide policy, Clay had represented he would cancel the Paul Revere policy, but instead had increased it; that Nationwide had breached no duty of good faith; and that Nationwide had a lawful basis for ceasing to make payments. Clay points out that Nationwide also denied having demanded premium payments and added as a defense that Clay "failed to mitigate his claim by undergoing corrective surgery within a reasonable period of time after becoming disabled." Nationwide withdrew this defense on the morning of trial.

The case went to trial on December 13, 1982, and the trial lasted through December 17. The trial court denied motions by Nationwide for directed verdict at the close of Clay's evidence and at the close of all the evidence. At the close of all the evidence, the trial court granted Clay's motion for directed verdict on the contract count and denied it on the bad faith count. The court granted a directed verdict for Nationwide on the fraud count. On the contract claim, the trial court awarded $46,165.00. The jury returned a verdict on $1,250,000.00 on the bad faith claim. The trial court later denied Nationwide's motion for judgment notwithstanding the verdict, new trial, or remittitur. Nationwide appealed.

ISSUES

Nationwide states eleven issues, but agues them under the following four headings: 1) The trial court erred in directing a

verdict for Clay under the contract claim; 2) The trial court erred in denying Nationwide's motions for directed verdict on the bad faith claim; 3) Various rulings by the trial court improperly and materially prejudiced the defendant; and 4) The trial court erred in refusing to order a remittitur. We shall discuss the issues under corresponding headings.

THE CONTRACT CLAIM

Nationwide argues that the court should not have directed a verdict for Clay because there was evidence in favor of Nationwide's position that it was not liable on the contract claim. Nationwide asserts that there was substantial evidence that Clay misrepresented his income and falsely stated that he would cancel the Paul Revere policy. According to Nationwide, each of these misrepresentations provided a basis upon which to void the policy. Nationwide further agues that the dispute as to the amount due on the policy makes the directed verdict improper.

Regarding Clay's statement on the application that his income was $1800 per month, Nationwide's primary argument is that, although Clay's deposits to his law office account for 1976 totalled $26,714.41, his office overhead averaged $900 to $1000 per month and thus his income was less than $1800 per month. Nationwide argues that it does not have to prove that Clay intentionally misstated his income, because Code 1975, § 27-14-7, provides that

> "Misrepresentations, omissions, concealment of facts, and incorrect statements shall not prevent a recovery under the policy or contract unless either:
>
> (1) Fraudulent;
>
> (2) Material either to the acceptance of the risk or to the hazard assumed by the insurer; or
>
> (3) The insurer in good faith would either not have issued the policy or contract, or would not have issued a policy or contract at the premium rate as applied for, or would not have issued a policy or contract in as large an

> amount or would not have provided coverage with respect to the hazard resulting in the loss if the true facts had been made known to the insurer as required either by the application for the policy or contract or otherwise.

Nationwide argues that it would not have issued as much coverage if it had known the true amount of Clay's income.

This argument depends upon Nationwide's position that "average earned monthly income" on the application means "net income" after deduction of office overhead. Nothing on the application compels such a conclusion, but Nationwide argues that its "Agent's Portfolio," introduced as Plaintiff's Exhibit 13, defines income so as to require deduction of expenses. Under "Monthly Indemnity Benefits," that exhibit defines "earned income" as "1. Income before taxes arising from occupation, or 2. Net income, after expenses, but before taxes, arising from the operation of a business."

The trial court observed that

> "there's no definition of income in the policy. The policy is to be construed against the insured [sic]. There is gross income and there's net income. If a person is disabled to work it doesn't presuppose that he's going to go out and fire his secretary and close his office immediately. He may go back to work in six months. And I would think that it means gross income."

Although the record indicates that the trial court stated that the policy is to be contrued against the "insured," this is clearly either a typographical error or a slip of the tongue. The trial court correctly applied the rule that ambiguities are to be construed against the insurer. See the many cases cited in 12 Alabama Digest *Insurance* Key # 146.7(1). See, for example, *Employers Ins. Co. of Alabama v. Jeff Gin Co.*, 378 So. 2d 693 (Ala. 1979); *Alabama Farm Bureau Ins. Co. v. McCurry*, 336 So. 2d 1109 (Ala. 1976); and *Mutual Benefit Health & Accident Ass'n of Omaha v. Reid*, 279 Ala. 136, 182 So. 2d 869 (1966).

Counsel for Clay cited to the court the cases of *Rambin v. Continental Casualty Co.*, 186 So. 2d 861 (La. Ct. App. 1966), *writ refused*, 249 La. 578, 187 So. 2d 740 (1966); and *Allstate Ins. Co. Co. v. Winnemore*, 413 F.2d 858 (5th Cir. 1969). In the former, the Louisiana court held that "'average monthly earnings' is ambiguous," that "'earnings' . . . does not necessarily mean 'net earnings' unless qualified in some manner," and that the interpretation most favorable to the insured would be adopted. 186 So. 2d at 864. In the latter case, the Fifth Circuit Court of Appeals stated that even though an innocent misrepresentation might void the policy, "[W]e think it is possible that if Winnemore did not know or could not be expected to know the meaning of 'earnings' on the insurance application, he did not make a misrepresentation." 413 F.2d at 863.

Nationwide cites *General Accident, Fire & Life Assurance Corp. v. Jordan*, 230 Ala. 407, 411, 161 So. 240, 242 (1935), for the Court's statement, "That [plaintiff] was repaid for his business expenses is not, in our opinion, a part of his earnings." Reimbursement for out-of-pocket expenses, however, is quite different from fees earned by an attorney: in the former case, the individual pays his expenses out of ordinary income, and inclusion of reimbursement as income would cause the sum to be included twice. On the other hand, an attorney would normally consider the entire amount of a fee paid to him as income, and could not be expected to deduct expenses unless specifically instructed to do so.

We agree with the trial court and the cited authorities that Nationwide's failure to tell Clay that "average earned monthly income" means *net* income prevents it from avoiding coverage on this ground. Furthermore, even within Nationwide's internal rules, there is an ambiguity as to whether Clay's law practice would constitute an occupation or a business, and only in the latter instance would expenses be deducted. Finally, the "Relation of Earnings to Insurance" clause of the policy contemplates the use of a two-year period to determine average monthly earnings. In the two-year period preceding the application, Clay averaged over $2,000 income per month even

after the deduction of office expenses. Thus, the trial court's decision to rule for Clay on this issue was eminently proper: not only did Clay have no reason to suspect he should give a "net income" figure, but also Nationwide's own rules, interpreted strictly against the insurer, preclude the use of a one-year net income average for a professional, whose income arises from an occupation, not a business.

Nationwide also argues that the trial court erred in granting a directed verdict on the contract count, because Clay represented that he would cancel the Paul Revere policy, but, instead, increased it. This argument has two branches: one, that Nationwide should not have to pay benefits because of the misrepresentation; and two, that the trial court should not have directed a verdict because the existence of other insurance presented a factual question on the amount of benefits due. Clay's response essentially is that he did cancel the existing policy as he said he would do, and the fact that he took out higher coverage with Paul after he obtained the Nationwide policy does not allow Nationwide to avoid coverage under its policy. He asserts that the calculation of benefits due was a simple matter of arithmetic and Nationwide made no objection before the jury retired to the trial court's performing this calculation.

The trial court made the following remarks during agument about the admissibility of evidence on this issue:

> "That's not going to be a defense as far as this Court is concerned. . . . A man notifies an insurance company that he's going to cancel it and the agent comes back out and talks him out of it; it's absolutely clear to me that it's not a misrepresentation if he did what he said he was gonna do. And, that's undisputed, isn't it?
>
> "[Attorney for Nationwide]: Your Honor, it's not his intentions, it's what he does, his actions.
>
> "The Court: Well, you're asking him to be held responsible for what the insurance company caused.

". . . .

"You know, to me it is just absolutely irrelevant. I mean, because the representation is that he was going to cancel it. That's what he tried to do. That's undisputed. Then he decides he's going to get another policy. That's undisputed. How the company treated that new policy, he didn't even know about that. What difference . . . I can't see what difference it makes.

" . . .

"I don't know how you can possibly hold an insured to what an insurance company does, how they internally treat something. That's the reason I don't see any relevance."

Paul Revere's agents treated the policy issued to Clay in February 1977 as a "make-over" of the policy he had at the time he applied for the Nationwide policy. Nationwide insists that this indicates Clay did not cancel the existing policy and thus that he made a misrepresentation when he said he would cancel it; and that this misrepresentation gives Nationwide a basis for rescinding its policy.

The difference between increasing the pre-existing policy and taking out a new policy after securing the Nationwide policy comes into play for the following reason: if Nationwide takes an application to supplement an existing policy, it will deduct the existing coverage from the amount of coverage it is otherwise willing to provide. Nationwide will write disability insurance for approximately half of an insured's income, reasoning that more coverage would be "overinsurance," tempting the insured to prolong a disability. Thus, with Clay stating that he made $1800 per month, if he had said he would keep the Paul Revere coverage of $400 per month, Nationwide would have provided only $500 additional coverage.

On the other hand, as a Nationwide underwriter testified, Nationwide cannot control what an insured does after he takes out a policy with Nationwide. Therefore, the policy includes

the "Relation of Earnings to Insurance" clause. This clause provides that, if the total "loss of time" coverage exceeds the insured's monthly income "at the time disability commenced or his average monthly earnings for the period of two years immediately preceding a disability . . ., whichever is greater," Nationwide will pay a prorated amount of benefits and return the excess premiums.

As it turned out, when Clay made his claim Paul Revere reduced its coverage to $1250 per month with an additional one-year benefit of $150 per month. The trial court calculated the benefits due under Clay's Nationwide policy when it directed a verdict on the contract claim. These calculations were not preserved in the record. Clay, in his appellee's brief, provides calculations which would justify the $46,165.00 award made by the trial court. He states, moreover, that these calculations give Nationwide the benefit of the doubt in three respects: they allow proration of his Nationwide policy in spite of Harker's representation that the Paul Revere, not the Nationwide, policy should be prorated; they allow the relation-of-earnings provision to apply to the $1300-per-month rider, which is inconsistent with Nationwide's position that the waiver-of-premium provision in the policy did not apply to the rider; and they do not give Clay any refund of excess premiums for prorated benefits.

Clay further makes the argument that when Harker denied coverage on the basis of a pre-existing condition, he waived the defense of misrepresentation regarding cancellation of the Paul Revere policy, because he already knew of the $2200 Paul Revere policy.

Nationwide argues that the "stacking" of coverage shows an intent to defraud. Clay's attorney responded at trial that Nationwide had not pled a defense raising this issue, and the court agreed: "It doesn't make any difference how many policies he has unless you are relying upon a defense that he knew he was going to be disabled." During this colloquy, which occurred during Clay's testimony on the third day of trial, the court remarked:

"Well I'll just tell you and I'll put it on the record, I'm prepared at this time to direct a verdict for the Plaintiff on the main claim and submit only the issue of bad faith to the jury. I just don't see any, absolutely no defense and I don't understand why this claim was not paid. It's something I must decide. The jury must decide whether or not it was denied based on bad faith. But I don't see any legitimate arguable defense in this case.

" . . . .

"I just don't think at this point, absent some other evidence, that there is any arguable defense based upon the defenses you presented to me . . . . "

Nationwide argues that these remarks were improper because it had not yet begun to put on its case. However, the court did not direct a verdict at this time, but did so only at the close of all the evidence. Moreover, the court stated that its conclusion was tentative, "absent some other evidence."

Nationwide points to the fact that Clay made no answer to the question on the claim form asking whether he had other insurance. The question, however, asked for "any other Companies with whom you may carry Accident & Sickness insurance." Clay testified that he thought of disability coverage as "income insurance" and thought the question meant medical insurance. Indeed, Clay's policy is titled a "Disability Income Policy." See *Mutual Benefit Health & Accident Ass'n of Omaha v. Reid*, 279 Ala. 136, 182 So. 2d 869 (1966), in which the Court held that a clause in a health and accident policy referring to "other insurance" did not include a life insurance policy providing additional benefits for death or disability by accidental means.

At any rate, when he talked to Otey on the telephone, Otey said he was aware of the Paul Revere and National Home policies. Furthermore, the existence of the Paul Revere policy came to Nationwide's attention before Harker denied coverage

based on a pre-existing condition, so Clay argues that Nationwide waived any defense on this basis.

We find no error in the trial court's action. Paul Revere issued the $2200 policy after Nationwide issued its policy. Since the higher Paul Revere policy was not in existence at the time Nationwide issued coverage, it could have had no effect on Nationwide's decision to issue its policy. Therefore, while the Paul Revere policy might have effect on the amount of benefits due under the Nationwide policy, it could not serve to void the Nationwide policy completely.

Neither does Nationwide present any error in the trial court's decision to calculate the amount of benefits due under the contract. The only objections Nationwide made were to the general issue of directing a verdict on the contract count. When the trial court repeatedly stated that it would calculate the benefits, Nationwide made no objection. Neither did it make any effort to preserve a record of the manner in which the trial court made the calculation. Thus the only question presented for our review is the actual decision to direct a verdict on the contract count, and we have resolved that question above.

THE BAD FAITH CLAIM

Nationwide argues that the numerous disputes raised questioning Clay's disability, income, and other insurance show that there were arguable reasons for denying the claim and thus it was error for the trial court to deny its motion for directed verdict on the bad faith claim.

The trial court correctly instructed the jury on the elements of an action for bad faith refusal to pay an insurance claim:

> "An insurer is liable for its refusal to pay a direct claim when there is no lawful basis for the refusal coupled with actual knowledge of that fact.
>
> "No lawful basis means that the insurer lacks a legitimate or an arguable reason for failing to pay a claim. When

a claim is fairly debatable, the insurer is entitled to debate whether the debate concerns a matter of fact or one of law.

"In order for the Plaintiff to recover, he must satisfy you from the evidence as to the following things:

"(One) That there was an insurance contract between the parties and a breach of that contract by the Defendant.

"(Two) An intentional refusal to pay the insurance claim;

"(Thirdly) The absence of any arguable or legitimate reason for that refusal; the absence of a debatable reason to pay the claim [sic].

"And, lastly, the insurer's knowledge or actual knowledge of the absence of any legitimate or arguable reason.

"In short, the Plaintiff must go beyond the mere showing of non-payment and must prove a bad faith non-payment. A non-payment without any reasonable grounds for dispute, or, stated differently, the Plaintiff must show that the insurance company had no legal or factual defense to the insurance claim.

"Whether an insurance company is justified in denying a claim under a policy must be judged by what facts it had before it at the time the decision was made to deny the claim."

We note that these instructions omitted the element of "intentional failure to determine whether or not there was any lawful basis for such refusal." See, e.g., *Cincinnati Ins. Co. v. Little*, 443 So. 2d 891 (Ala. 1983); *National Savings Life Ins. Co. v. Dutton*, 419 So. 2d 1357 (Ala. 1982); and *National Security Fire & Cas. Co. v. Bowen*, 417 So. 2d 179 (Ala. 1982).

Nationwide argues that the element of refusal to pay is lacking because Nationwide made four payments on the claim and ceased only because Clay, instead of providing income

information in response to Nationwide's March 28, 1978, letter, filed this lawsuit.

Clay responds that Nationwide's repeated refusals to cooperate justified him in disbelieving the letter's statement that the income information would settle the matter. He states that the course of negotiating the claim—the failure to return his calls, the refusals to locate his file, and the denials of receiving letters and reports (which did in fact turn out to be in his file)—show at least a bad faith failure to investigate, if not that Nationwide's periodic refusals to pay were made with actual knowledge of a lack of an arguable reason.

Clay also argues that Harker's decision to deny coverage based on a pre-existing condition waived a defense of misrepresentation that the Nationwide policy would replace the Paul Revere policy. He says this choice of grounds for denying the claim constitutes a waiver because Harker knew at the time he made this denial of coverage that Clay had a Paul Revere policy in effect. We need not reach this claim that such a waiver shows that Nationwide later raised the "other insurance" and "insufficient income" grounds in bad faith. There was sufficient evidence of bad faith assertion of these grounds without a finding that Nationwide had waived them as a matter of law.

Harker stated that he decided that Clay might not have sufficient income on the sole basis that Clay had not filed income tax returns, and he refused to explain to Clay why he wanted the income information. This evidence supports a finding that Harker's attempt to have Clay prove he was entitled to coverage was made in bad faith. When this evidence is considered along with the evidence of Nationwide's seriatim assertions of grounds for denying coverage, which were not supported by the facts and documents before Otey and Harker, but only by their assumptions, it becomes clear that the evidence was sufficient to go to the jury on the bad faith claim. Therefore, the court did not commit error in denying Nationwide's motion for directed verdict on that claim.

RULINGS BY THE TRIAL COURT

This group of arguments presupposes that the trial court was in error on the merits on various aspects of the case. Most of the rulings complained of have been set out or discussed specifically above. We need not address the others explicitly because to do so would only require a reiteration of the holdings already made herein.

REMITTITUR

Nationwide insists that the verdict on the bad faith claim was excessive under the facts of the case. We disagree. The uncooperative, intransigent behavior of the Nationwide agents is the very thing the bad faith action is designed to prevent. The verdict is large, but not out of proportion to the wrong.

The judgment is affirmed.

AFFIRMED.

Faulkner, Jones, Shores, Embry, and Adams, JJ., concur.

Torbert, C. J., dissents in part and concurs in part, with opinion, in which Beatty, J., concurs.

Maddox, J., dissents with opinion.

82-536 *Nationwide Mutual Ins. Co. v. Clay*

TORBERT, CHIEF JUSTICE (dissenting in part and concurring in part).

I dissent from that part of the majority opinion which affirms the bad faith judgment for Clay. Once again we are faced with a bad faith claim where the facts unquestionably show that the insurer's conduct was not an example of how to properly process a claim made by an insured. To the contrary, the claim was badly handled, but this is clearly not the issue here. And as I said in *Aetna Life & Casualty Insurance Co. v. Lavoie*, [Ms. December 7, 1984] ____ So. 2d ____ (Ala. 1984), and *Continental Assurance Co. v. Kountz*, [Ms. December 21, 1984] ____ So. 2d ____ (Ala. 1984), alternatives to the tort of bad faith should be pursued in order to regulate the improper conduct of insurers. However, the question presented here is whether a jury could find that this insurer's conduct rose to the level of "bad faith" as currently defined by this Court.

First, I will address the propriety of the directed verdict on the contract claim. Nationwide contends that Clay's misrepresentation of income on the application entitles Nationwide to void the policy. Obviously, the first inquiry should be whether Clay in fact made a misrepresentation as to his "average earned monthly income." Nationwide maintains that the term "average earned monthly income" means the average of net monthly income, that is, gross income less expenses. However, there is no evidence that Clay knew that Nationwide meant *net* "average earned monthly income." It is only if neither Clay's net nor his gross "average earned monthly income" was the amount stated that it could be said that Clay misrepresented his income. At trial it became clear that using either a one-year or two-year average of monthly earnings prior to the disability, Clay's gross income was at least the amount stated in the application. Under the two-year average method, his net income also was at least the amounted stated in his application. The trial court's finding that there was no evidence to support the misrepresentation claim was correct.

Clay's level of income was important for another reason. The extent of Nationwide's liability under its "relationship of earnings to insurance" clause was a function of two factors, Clay's income and the amount of loss-of-time coverage Clay held with other insurers. I find no error in the trial court's determination of the extent of Nationwide's liability based upon the information produced at trial.

However, while at trial there was sufficient information from which the extent of Nationwide's liability could be determined, that information was not made available to Nationwide until just before trial. Whether Nationwide acted in "bad faith" depends upon whether at the time of denial of benefits, Nationwide had a debatable reason for denying the claim.[1] On the initial claim form submitted by Clay, the questions asking for monthly income and whether the insured had other insurance were not answered. Subsequently, Nationwide learned that Clay had not filed federal income tax returns for the years 1975, 1976, and 1977. The facts that Clay had not disclosed his income on the claim form and that he had not filed tax returns for the three years preceeding his disability were sufficient to create a debatable reason as to whether Clay had sufficient income to entitle him to the full benefits of the policy. Clay's adamant refusal to reveal any finanacial information, no matter how justified he may have felt in refusing to answer, certainly served to confirm Nationwide's concerns that Clay's income was not what Clay originally represented in his application.

I believe that Nationwide had a debatable reason for questioning the extent of its liability and that the existence of this debatable reason precludes a finding of bad faith.

Beatty, J., concurs.

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[1]This is clearly a "first tier" bad faith case, as the trial court did not even charge the jury as to the "second tier" of bad faith.

83-536 *Nationwide Mutual Ins. Co. v. Clay*

MADDOX, JUSTICE (Dissenting).

I believe there was at least a "scintilla" of evidence of a factual dispute between the parties over whether the terms "average earned monthly income" in the policy meant "net income" after deduction of office overhead; therefore, a directed verdict on the contract count was error, in my opinion. On the bad faith portion of the claim, I remain convinced that these disputes could best be resolved by the procedure I outlined in my dissent in *Continental Assurance Co. v. Kountz* [MS. 82-793, December 21, 1984], ____ So. 2d ____ (Ala. 1984).

APPENDIX B

Nationwide Mut. Ins. Co. v. Clay
82-536 & 82-917

FILED
April 5, 1985
Clerk
SUPREME COURT OF ALABAMA

---

made this denial of coverage that Clay had a Paul Revere policy in effect. We need not reach this claim that such a waiver shows that Nationwide later raised the "other insurance" and "insufficient income" grounds in bad faith. There was sufficient evidence of bad faith assertion of these grounds without a finding that Nationwide had waived them as a matter of law.

Harker stated that he decided that Clay might not have sufficient income on the sole basis that Clay had not filed income tax returns, and he refused to explain to Clay why he wanted the income information. This evidence supports a finding that Harker's attempt to have Clay prove he was entitled to coverage was made in bad faith. When this evidence is considered along with the evidence of Nationwide's seriatim assertions of grounds for denying coverage, which were not supported by the facts and documents before Otey and Harker, but only by their assumptions, it becomes clear that the evidence was sufficient to go to the jury on the bad faith claim. Therefore, the court did not commit error in denying Nationwide's motion for directed verdict on that claim.

RULINGS BY THE TRIAL COURT

This group of arguments presupposes that the trial court was in error on the merits on various aspects of the case. Most of the rulings complained of have been set out or discussed specifically above. We need not address the others explicitly because to do so would only require a reiteration of the holdings already made herein.

REMITTITUR

Nationwide insists that the verdict on the bad faith claim was excessive under the facts of the case. In light of the punitive nature of the damages, we find nothing in the record to show that the jury exceeded its discretion. There was no evidence before the trial court that paying the verdict would be unduly oppressive to Nationwide. Nationwide's repeated unjustified denials of Clay's valid claim constitute the very type of claims handling which the bad faith action is designed to prevent. The jury fixed the amount and there is no evidence of "bias, prejudice, corruption, or other improper motive," which would require the trial court to set aside the jury's verdict. *Shiloh Const. Co. v. Mercury Const. Corp.*, 392 So. 2d 809 (Ala. 1980); *B & M Homes, Inc. v. Hogan*, 376 So. 2d 667 (Ala. 1979). The trial court denied Nationwide's motion for JNOV, new trial, or remittitur.

The judgment is affirmed. AFFIRMED.

Faulkner, Jones, Shores, Embry, and Adams, JJ., concur.

Torbert, C. J., dissents in part and concurs in part, with opinion, in which Beatty, J., concurs.

Maddox, J., dissents with opinion.

ON APPLICATION FOR REHEARING

ALMON, JUSTICE.

OPINION MODIFIED. APPLICATION OVERRULED.

Faulkner, Jones, Shores, Embry, and Adams, JJ., concur.

Torbert, C. J., Maddox, and Beatty, JJ., dissent.

ON MOTION FOR WITHDRAWAL OF OPINION AND SUGGESTION OF DISQUALIFICATION

PER CURIAM.

Motion denied on the authority of *Aetna Life & Casualty Co. v. Lavoie*, ____ So. 2d ____ (Ala. 1985) [Ms. March 8, 1985]

MOTION DENIED.

All the Justices concur.

APPENDIX C

IN THE SUPREME COURT OF ALABAMA

Case Number 82-536
82-917

NATIONWIDE MUTUAL INSURANCE COMPANY,
Appellant,

v.

HENRY GERRARD CLAY,
Appellee.

FILED
Feb. 22, 1985
Clerk
SUPREME COURT OF ALABAMA

MOTION FOR WITHDRAWAL OF OPINIONS AND SUGGESTION OF DISQUALIFICATION

Comes now appellant Nationwide Mutual Insurance Company ("Nationwide") and moves that the opinion in this cause announced February 8, 1985 (along with recent opinions in two other appeals), be withdrawn, that all of the justices of this Court recuse themselves, and for other relief. As grounds therefor, Nationwide says as follows:

1. On January 19, 1984, an action was filed in the name of T. Eric Embry in the District Court of Jefferson County, Alabama, seeking, among other things, punitive damages for the tort of bad faith against Maryland Casualty Company wherein plaintiff T. Eric Embry alleged, among other things, ". . . that defendant in bad faith, willfully, intentionally, and/or maliciously failed to pay a valid claim under the aforementioned

insurance contract without lawful excuse." Certified copies of the complaint and the case action summary in the action are attached hereto as Exhibit A and incorporated herein by reference. That action was dismissed with prejudice at defendant's cost on or about April 6, 1984.

2. On January 31, 1984, an action was filed in the name of T. Eric Embry in the Circuit Court of Jefferson County, Alabama, seeking, among other things, punitive damages for the tort of bad faith against Blue Cross/Blue Shield of Alabama. Plaintiff T. Eric Embry alleged in that action, among other things, that Blue Cross and Blue Shield ". . . has committed the tort of bad faith . . . in failing and refusing to pay to plaintiff and other members of the class the benefits to which they are entitled pursuant to the insurance policy or contract. . . ." The intensity of plaintiff T. Eric Embry's feeling is evidenced by his allegation seeking compensatory damage for "breach of contract, inconvenience, emotional and mental distress, disappointment, pain and suffering." Certified copies of the complaint and the case action summary in that action are attached hereto as Exhibit B and incorporated herein by reference. That action is still pending.

> (NOTE: As is noted in Exhibit B, plaintiff T. Eric Embry has brought this action ". . . on behalf of himself and all other persons who are members of the Alabama State Employees Health Insurance Plan carrying medical and hospitalization insurance through Blue Cross/Blue Shield of Alabama, Group Policy Number 1300." No resolution has yet been made by the trial court on plaintiff T. Eric Embry's request for "an order certifying this class as a class action pursuant to Rule 23, Alabama Rules of Civil Procedure.")

3. On the morning of March 28, 1984, Associate Justice T. Eric Embry sat as one of the five justices hearing oral argument on this appeal involving, among other things, a $1,250,000.00 tort of bad faith punitive damage judgment against Nationwide. During that oral argument which pri-

marily centered on the question of "bad faith" damages, Mr. Justice Embry never mentioned to counsel the fact that he was a plaintiff in two bad faith damage suits against insurance companies then pending in the District and Circuit Courts of Jefferson County.

4. Presumably Associate Justice T. Eric Embry thereafter actively participated in conference with all of his fellow justices of this Court in the decision-making process on this case. Mr. Justice Embry was one of the majority in the 6 to 3 decision announced February 8, 1985, affirming the $1,250,000.00 bad faith punitive damage decision due to the ". . . uncooperative, intransigent behavior of the Nationwide agents," even though there was no finding of oppressiveness or maliciousness. He was joined in that majority decision by the other three members of his judicial panel, with a majority decision having been written by one of the justices of that panel.

5. Subsequent to the initial recognition of the tort of bad faith in the cases of *Chavers v. National Security Fire and Casualty Company*, 405 So.2d 1 (Ala. 1981), and *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916 (Ala. 1981), both announced on October 2, 1981, this Court had issued a series of opinions sharply limiting application of the tort of bad faith. In an unbroken line of 11 straight cases decided in the following three years by this Court on the subject of bad faith, in each instance the Court ruled in favor of the insurance company appellant or appellee in holding the tort of bad faith inapplicable to the facts of each such case . . . repeatedly emphasizing "the heavy burden that a plaintiff must bear in a bad faith case." A chart diagraming those cases and the recent bad faith holdings is attached hereto as Exhibit C and incorporated herein by reference.

6. However, in the 5 to 4 per curiam decision of December 7, 1984, in *Aetna Fire and Casualty Company v. Lavoie*, 19 ABR 271, this Court for the first time since October, 1981, found bad faith existent and affirmed a punitive damage award against an insurance company in the amount of $3.5 million. The other

three members of Mr. Justice Embry's panel joined him in the majority opinion.

7. On December 21, 1984, in the case of *Continental Assurance Company v. Kountz*, 19 ABR 462, Associate Justice T. Eric Embry and the other three members of his judicial panel again joined with the majority of the Court in affirming another bad faith punitive damage verdict. That same day (in a decision in which Mr. Justice Embry and the other three members of his panel did not participate) this Court ruled in favor of an insurance company in *Tyson v. Safeco Insurance Companies*, 19 ABR 523, holding that bad faith did not apply. Also on December 21, 1984, this Court reversed a $500,000.00 bad faith award in the case of *Blue Cross/Blue Shield v. Granger*, 19 ABR 444, a case in which Mr. Justice Embry and one other member of his panel had recused themselves.

8. Associate Justice T. Eric Embry and the other three members of his judicial panel were the only Justices of this Court who ruled with the plaintiff in all three of the recent affirmances of bad faith awards. That hardline unanimity is a new phenomenon. Mr. Justice Embry himself dissented from the original recognition of bad faith in *Chavers v. National Security Fire and Casualty Company, supra*. Another member of Mr. Justice Embry's judicial panel dissented in both *Chavers* and the companion holding in *Gulf Atlantic Life Ins. Co. v. Barnes, supra*.

9. Prior to the December 7, 1984, affirmance in *Aetna Fire and Casualty Company v. Lavoie, supra*, the only bad faith punitive damage award affirmed by this Court was in the October 2, 1981, case of *Gulf Atlantic Life Ins. Co. v. Barnes, supra*. However, in *Barnes*, even after concluding that "the jury could reasonably have concluded that the insurer tried to cover its 'mistake' without any existing debatable reason," this Court held (at p. 926) as follows:

> "The judgment rendered against the insurance company in the amount of $1,100,000.00, however, is excessive and

> obviously the result of passion and prejudice on the part of the jury."

This Court in *Barnes, supra*, then ordered a remittitur whereby the punitive damage award was reduced from $1,100,000.00 to only $100,000.00. However, in *Aetna Fire and Casualty Company v. Lavoie, supra*, decided on December 7, 1984, the majority of this Court in a per curiam opinion affirmed a $3.5 million award against an insurance company without attempting in any way to distinguish the remittitur holding in *Barnes, supra*. Likewise, in the opinion announced on February 8, 1985, in the instant case, a majority of the Court affirmed the $1,250,000.00 punitive damage bad faith award against Nationwide. Again there was not even an attempt to distinguish this case from the prior holding in *Barnes, supra*, reducing that damage award to less than 10 percent of the original verdict.

10. On February 14, 1985, Nationwide and its counsel first learned of Associate Justice T. Eric Embry's two bad faith suits against insurance companies as mentioned in paragraphs 1 and 2 of this motion. An affidavit to that effect is attached hereto as Exhibit D to this motion and incorporated herein by reference.

11. Alabama Code § 12-1-12 (1975) provides in pertinent part as follows:

> "No judge of *any* court shall sit in any case or proceeding in which he is interested . . . without the consent of the parties entered of record or put in writing if the court is not of record."

12. The Preamble to the Canons of Judicial Ethics adopted by the Alabama Supreme Court on December 15, 1975, and which became effective on February 1, 1976, is as follows:

> "The first Code of Legal Ethics in the United States was formulated and adopted by the Alabama State Bar Association in 1887. This first Code was adopted with only minor changes by Georgia, Virginia, Michigan, Colorado, North Carolina, Wisconsin, West Virginia, Maryland, Kentucky and Missouri between 1887 and 1906, and fi-

> nally by the American Bar Association in 1908. Recognizing Alabama's leadership in the field of professional ethics and mindful that the character and conduct of a judge should never be objects of indifference and that declared ethical standards tend to become habits of life, the supreme court of Alabama deems it desirable to formulate and establish those principles which govern the conduct of members of the judiciary. The supreme court of Alabama accordingly adopts the following canons, as a Code for judges and a declaration of that which the people of the state of Alabama have a right to expect of them."

Canon 1 of those canons is entitled, "A judge should uphold the integrity and independence of the judiciary," and provides:

> "An independent and honorable judiciary is indispensable to justice in our society. A judge should participate in establishing, maintaining, and enforcing, and should himself observe, high standards of conduct so that the integrity and independence of the judiciary may be preserved. The provisions of this Code should be construed and applied to further that objective."

Canon 2 of those canons is entitled, "A judge should avoid impropriety and the appearance of impropriety in all his activities," and provides in section A thereof as follows:

> "A. A judge should respect and comply with the law and should conduct himself at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary."

Canon 3 of those canons is entitled, "A judge should perform the duties of his office impartially and diligently," and provides in sections C(1)(d)(ii) thereof as follows:

> "C. DISQUALIFICATION:
> (1) A judge should disqualify himself in a proceeding in which his disqualification is required by law or his impartiality might reasonably be questioned, including but not limited to instances where:

• • •

(d) He or his spouse, or a person within the fourth degree of relationship to either of them, or the spouse of such a person:

• • •

(ii) Is known by the judge to have an interest that could be substantially affected by the outcome of the proceeding."

13. Having a bad faith action of his own against one insurance company pending at oral argument, throughout submission and to the present time, and having another bad faith action against a different insurance company pending at the time of oral argument in this case, Associate Justice T. Eric Embry had an interest in revitalizing and then expanding the application of the tort of bad faith, as well as in affirming (without remittitur) excessively large damage awards in "bad faith" cases.

14. Because of Associate Justice Embry's interest in the outcome of this case, under Alabama Code § 12-1-12 (1975) and under the aforesaid Canons of Judicial Ethics of this state, Mr. Justice Embry was and is disqualified from participating in this appeal.

15. Due to the patently improper participation of Associate Justice T. Eric Embry in this appeal and in the cases of *Aetna Fire and Casualty Company v. Lavoie, supra*, and *Continental Assurance Company v. Kountz, supra*, this entire appellate proceeding and the appellate proceedings and opinions in *Lavoie* and *Kountz* have been illegal and prejudicially unfair to Nationwide.

16. The other members of Associate Justice T. Eric Embry's judicial panel, the other two justices voting with the majority in this case, and even the dissenting justices have all been affected and influenced at least to some degree by the patently improper participation of Mr. Justice Embry in this appeal.

Appellate judges do not reach their decisions in a vacuum. They are influenced by each other as well as by their knowledge of the law and the record. Once one of the justices with a personal interest has entered into a discussion on the merits of a case in general conference, the opinions of that brother judge will have affected everyone who was a party to that discussion or discussions. It is not possible to erase recollection of remarks once heard, or undo impressions once created. If the viewpoint of even *one* justice was tainted by personal bias or interest (as in this instant case and in *Lavoie* and *Kountz*), then the opinions of all participants became tainted by their exposure to such bias. No one can ever know for certain what his or her opinion might have been if the biased judge's viewpoint had not been heard. This concern is all the greater where the court is closely divided. The only way to provide an impartial, unbiased determination is for the case to be heard and decided de novo by a special court empaneled under the provisions of Alabama Code § 12-2-14 (1975).

17. As observed in the 1974 decision of *Ex parte White*, 53 Ala. Crim. App. 377, 300 So.2d 420, the Supreme Court of the United States has many times in the history of our country written pronouncements concerning the requirements of due process and in the 1955 case of *In re Murchison*, 349 U.S. 133, 75 S.Ct. 623, 99 L.Ed. 942, it concluded that a fair trial in a fair tribunal is a basic due process requirement. Further, that court, speaking through Mr. Justice Hugo Black, held as follows:

> "Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness. To this end no man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome. That interest cannot be defined with precision. Circumstances and relationships must be considered. This Court has said, however, that 'Every procedure which would offer a possible temptation to the average man as a judge * * * not to hold the balance nice, clear,

> and true between the State and the accused denies the latter due process of law.' *Tumey v. State of Ohio*, 273 U.S. 510, 532, 47 S.Ct. 437, 444, 71 L.Ed. 749. Such a stringent rule may sometimes bar trial by judges who have no actual bias and who would do their very best to weigh the scales of justice equally between contending parties. But to perform its high function in the best way 'justice must satisfy the appearance of justice.' *Offutt v. United States*, 348 U.S. 11, 14, 75 S.Ct. 11, 12, 99 L.Ed. 11."

[*See Murchison*, 349 U.S. at 136, 75 S.Ct. at 625, 99 L.Ed at 946. *See also, Medlin v. Taylor*, 101 Ala. 239, 13 So. 310 (1893); *Ex parte Cornwell*, 144 Ala. 497, 39 So. 354 (1905); *Ex parte White, supra; Shell v. Shell*, 48 Ala. Civ. App. 668, 267 So.2d 461 (1972).]

18. Nationwide has been denied due process of the law.

WHEREFORE, Nationwide moves that this Court withdraw the opinion announced herein on February 8, 1985, and also withdraw the opinions previously announced in the recent cases of *Aetna Fire and Casualty Company v. Lavoie, supra*, and *Continental Assurance Company v. Kountz, supra*. Nationwide further moves that all the justices of this Court recuse themselves and that a special court be appointed to consider this appeal de novo, pursuant to the provisions of Alabama Code § 12-2-14 (1975). Nationwide prays for such other, further or different relief as may be appropriate under these premises.

BERT A. NETTLES

FORREST S. LATTA
Attorneys for Appellant and Movant Nationwide Mutual Insurance Company

Of Counsel:

NETTLES, BARKER & JANECKY
3311 First National Bank Building
Post Office Box 2987
Mobile, Alabama 36652
Telephone: 205/432-8786

Oral argument en banc is requested on this motion. This is a case of first impression. It is a uniquely serious situation certainly warranting oral argument before this Court en banc.

BERT S. NETTLES

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Motion upon Counsel for Appellee, Fred W. Killion, Jr., Esquire, Post Office Box 8158, Mobile, Alabama 36608, by placing a copy of same in the United States Mail, postage prepaid. Similar service has been made upon counsel of record in *Lavoie* and in *Kountz*.

Dated this 22nd day of February, 1985.

BERT S. NETTLES

EXHIBIT A

IN THE
DISTRICT COURT OF JEFFERSON COUNTY,
ALABAMA

Civil Action No. DV8400963

T. ERIC EMBRY,

Plaintiff,

V.

MARYLAND CASUALTY COMPANY,

Defendant.

Filed
January 19, 1984
District Court of Jefferson County Civil Division

COMPLAINT

A. During 1983, plaintiff and defendant entered into a homeowner's insurance policy contract, Policy No. THO48494058 covering the household effects and personal property of the plaintiff and his wife, Bedford Embry, at their house at 3609 Springhill Road, Birmingham, Alabama. There was a champagne mink coat valued at $2,000 listed on a schedule of covered property in the said homeowner's insurance policy. Defendant agreed to pay to plaintiff the replacement value of that said mink coat scheduled on that insurance policy should it be lost, damaged, or stolen.

B. On to-wit, November 23, 1983, plaintiff gave notice to defendant that the said mink coat was lost or stolen and de-

manded payment of the replacement value as shown in the said insurance contract. The defendant gave no response.

C. Sometime immediately prior to Christmas 1983, plaintiff called the defendant to inquire about the status of his claim for the mink coat. Defendant informed plaintiff that it had the claim and was processing it, presumably for payment, and that defendant would notify plaintiff within the next week or so.

D. The defendant has failed to respond whatsoever to plaintiff's claims for payment of the replacement value of the said fur which is due to be paid under the insurance contract mentioned above.

COUNT ONE

1. Plaintiff hereby adopts herein all of the previous paragraphs set forth above.

2. Plaintiff claims $2,000 damages from defendant for breech of the above mentioned insurance contract between plaintiff and defendant.

WHEREFORE, plaintiff demands judgment against defendant in the amount of Two Thousand Dollars ($2,000.00).

COUNT TWO

1. Plaintiff hereby adopts herein by reference all of the allegations in paragraphs A through D.

2. Plaintiff avers that defendant in bad faith, willfully, intentionally, and/or maliciously failed to pay a valid claim under the aforementioned insurance contract without lawful excuse. Plaintiff claims $3,000 damages for defendant's bad faith failure to pay a valid claim. Plaintiff claims punitive damages.

WHEREFORE, plaintiff demands judgment against defendant in the sum of Three Thousand Dollars ($3,000.00).

SIROTE, PERMUTT, FRIEND, FRIEDMAN, HELD & APOLINSKY, P.A.

By: _____

C. Lee Reeves
P. O. Box 55727
Birmingham, Alabama 35255
(205) 933-7111

PLAINTIFF'S ADDRESS:

3609 Springhill Road
Birmingham, Alabama 35233

PLEASE SERVE DEFENDANT AS FOLLOWS:

Maryland Casualty Company
940 Montclair Road
Birmingham, Alabama 35213

I hereby certify that this is a true and correct copy. This the 20th of Feb., 1985, Polly Consacli, Clerk

BEST AVAILABLE COPY

State of Alabama
Unified Judicial System

Form C-5A8J Rev 8/81

CASE ACTION SUMMARY
— CIVIL —

Case Number: DV 84 963
(ID / YR / Number)

IN THE DISTRICT COURT OF JEFFERSON COUNTY

CASE INFORMATION (Phone Numbers etc.)

PLAINTIFF(S)	DEFENDANT(S)	SVS DT
T Eric Embry 3609 Springhill Rd B'ham Al 35233	Maryland Casualty Company (940 Montclair Rd B'ham Al 35213)	

CASE NUMBER	AMOUNT	DATE FILED
☐ Jury ☐ Non Jury	$ 3000.00	1/19/84

1: damages/breach of contract $2000.00
2: contract/punitive damages $3000.00

ATTORNEY(S) FOR PLAINTIFF(S)	ATTORNEY(S) FOR DEFENDANT(S)
C. Lee Reeves Sirote, Permutt	

THIRD PARTY/GARNISHEE	ATTORNEY

Judge's I.D. No.

Plaintiff Indigent ☐ Y ☐ N

Disposition Type: Date

☐ For Plaintiff
☐ For Defendant
☐ Settled
☐ Dismissed
☐ Default
☐ Non-suit
☐ Other

DATE	ACTIONS, JUDGMENTS AND CASE NOTES
3-1-84	F.I.C. v. ~~Defendants~~ Fidelity Casualty
4-6-84	DISMISSED AT ~~PLAINTIFF'S~~ COST. with prejudice.
	Donald R. Owens Judge

I hereby certify that this is a true and correct copy.
This the 20th of Feb., 1985 Patty Cossatt Clerk

BEST AVAILABLE COPY

		TOTAL	$	☐ Continued

III. Disbursements/Paid To	Date Paid	Check Number	Amount Paid	Balance Due
		TOTAL	$	☐ Continued

I hereby certify that this is a true and correct copy.

This the 20th day of Feb., 19 85 Betty Conrad, Clerk

IV. Executions/Against/For	Total Amount	Date Paid	Date Del. To Sheriff	V. Sheriff's Return

FEE SHEET
(CIVIL)

Case Number

ID YR Number

atty VS.

I. Civil Fee Summary	Date	Date	Date	Date
1 Docket (Filing) Fee	Amt.	Amt.	Amt.	Amt.
Small Claims ($20)				
District ($38)	$38			
Circuit ($55)				
2 Law Library Tax	$2			
3 Jury Demand ($15)				
4 Service Fees				
Each def over one ($7)				
Non-resident def. ($7)				
Certified Mail				
Subpoena each ($4)				
5 Witness Fees				
$1 50/Day $.05/Mile				

Summary Continuation	Date	Date	Date	Date
	Amt.	Amt.	Amt.	Amt.
6. Publication				
7. Judgments				
8 Post Judgment Fees				
Attachments ($11)				
Garnishment ($11)				
Execution ($7)				
9 Lower Court Costs				
10 Other				
TOTAL COSTS				

II. Cash Receipts/From	Date Received	Receipt Number	Amount Received	Balance Due

EXHIBIT B

IN THE CIRCUIT COURT
FOR THE TENTH JUDICIAL CIRCUIT
JEFFERSON COUNTY, ALABAMA

Civil Action No. 500 447

T. ERIC EMBRY,

Plaintiff, on behalf of himself and all other persons who are members of the Alabama State Employees Health Insurance Plan carrying medical and hospitalization insurance through Blue Cross/Blue Shield of Alabama, Group Policy Number 1300,

V.

BLUE CROSS/BLUE SHIELD OF ALABAMA,

Defendant.

Filed in Office
Jan 30, 1984 P4:17
D.I. Cockrell, Register

COMPLAINT

Parties

1. Plaintiff, T. Eric Embry, is an adult resident citizen of Jefferson County, Alabama.

2. The defendant, Blue Cross/Blue Shield of Alabama is a corporation organized and existing under and by virtue of the laws of the State of Alabama with its principal place of business in Jefferson County, Alabama.

Factual Allegations

3. On to wit: 1 October, 1982, plaintiff, T. Eric Embry, was enrolled as a member of the Alabama State Employees Health Insurance Plan, a plan under which he and his dependent wife, Bedford Stall Embry (deceased as of 20 September, 1983) were insured against monetary losses resulting from Hospital-Surgical-Medical and Major Medical expenses subject to all the terms and conditions and limitations of a master contract between the State of Alabama and Blue Cross/Blue Shield of Alabama as Administrator of the plan. That contract is commonly known and referred to as Group Number 13000 by said Administrator. The Plaintiff and his wife were insured under the Plan, having contract number 418122167. From and after 1 October, 1982 to the date of the filing of this complaint plaintiff has remained insured under the said Plan and the premiums have been paid and continue to be paid on behalf of the Plaintiff by the State of Alabama as a part of the benefits of his employment by the State. Premiums for dependent coverage under said plan for Plaintiff's late wife were paid monthly, from 1 October, 1982 through 20 September, 1983 by the Plaintiff.

Pursuant to Rule 23 of the Alabama Rules of Civil Procedure, this action is brought on behalf of the Plaintiff, T. Eric Embry, and all other persons who are members of the Alabama State Employees Health Insurance Plan carrying medical and hospitalization insurance through Blue Cross/Blue Shield of Alabama, Group Policy Number 13000.

Class Action Allegations

4. The Plaintiff avers, on information and belief, as follows:

a) That the members of the class as defined in the preceding paragraph are so numerous that joinder of all members is impractical.

b) That there are hundreds of persons who are members of the class as defined hereinabove.

c) That there are questions of law and fact common to the said class.

d) That the said questions of law and fact common to the members of the said class include, but are not limited to, the following:

i) Whether the defendant, Blue Cross/Blue Shield of Alabama has in effect a master contract of medical and hospitalization insurance with the State of Alabama whereby employees of the State of Alabama and their enrolled dependents are insured against monetary losses resulting from certain medical and hospital expenses.

ii) Whether or not the defendant, Blue Cross/Blue Shield of Alabama, has a policy or custom of unreasonably delaying payment of valid claims made by insureds under the said group policy.

iii) Whether the defendant, Blue Cross/Blue Shield of Alabama, has a policy or practice of paying to medical providers only such amount or amounts as Blue Cross/ Blue Shield unilaterally deems to be "reasonable" for the particular service, charge or procedure, regardless of what the provider may actually charge.

iv) Whether the defendant, Blue Cross/Blue Shield of Alabama, charges insurance premiums to the Alabama State Employees Health Insurance plan based on the actual charges of medical providers for their services, medical procedures, and medical treatment.

v) Whether the defendant, Blue Cross/Blue Shield of Alabama, charges premiums to the Alabama State Employees Health Insurance Plan, for Group Policy Number 13000, the cost of which is based on the actual charges of medical providers for their services, treatment and procedures, while simultaneously refusing to pay to those medical providers the amount of any actual charge which exceeds that which the defendant, in its unilateral opinion, deems "reasonable".

e) The claims of Plaintiff are typical of the claims of the said class.

f) Plaintiff will fairly and adequately represent the interests of said class.

g) Prosecution of separate actions by individual members of said class would create a risk of:

i) Inconsistent or varying adjudications with respect to individual members of the class sued for which would establish incompatible standards of conduct for the defendant; and

ii) Adjudications with respect to individual members of the class sued for, which would as a practical matter, because of the applicable statutes of limitation, and because of the expense of trial, depositions and other discovery procedures, be dispositive of the interests of other members of the class sued for, not parties to the adjudications, or substantially impair or impede their ability to protect their interests.

h) The acts of the defendant alleged in this complaint are wrongs against each and every member of said class sued for herein, on the grounds generally applicable to the said class and each member thereof, making appropriate declaratory relief with respect to the class sued for as a whole.

i) The actions of the defendant as set forth hereinabove were all pursuant to a common course of conduct, custom or policy of the defendant which operated as a breach of contract and a breach of duty to the plaintiff and others similarly situated.

j) The questions of law and fact common to the members of the class sued for here predominate over any questions affecting only individual members.

k) Permitting a class action herein is and will be superior to other available methods for the adjudication of controversies and claims set out herein between members of the class sued for and the defendants herein.

Factual Allegations

Plaintiff avers that he is an employee of the State of Alabama. On to wit: October 1, 1982, the plaintiff, T. Eric Embry, was enrolled as a member of the Alabama State Employees Health Insurance Plan, a plan under which he and his dependent wife, Bedford Stall Embry (deceased as of September 20, 1983) were insured against monetary losses resulting from Hospital-Surgical-Medical and Major Medical expenses subject to all the terms and conditions and limitations of a master contract between the State of Alabama and Blue Cross/Blue Shield of Alabama as Administrator of the plan. That master contract is known as Group Policy Number 13000. Plaintiff and his wife were insured pursuant to the said plan, having contract Number 418122167. From and after October 1, 1982 to the date of the filing of this complaint, Plaintiff has remained insured under the said Plan and the premiums paid and continue to be paid on behalf of the Plaintiff by the State of Alabama as a part of the benefits of his employment by the State. Premiums for the dependent coverage under said Plan for Plaintiff's late wife were paid monthly, from October 1, 1982 through the date of her death, September 20, 1983, by the Plaintiff.

5. Plaintiff claims that during and throughout the period October 1, 1982 to the date of filing of this complaint, the plaintiff and his wife, now deceased, underwent numerous medical procedures, incurred various expenses for medical treatments, medications, and other medical and surgical treatment. During and throughout the period October 1, 1982 to the date of the filing of this complaint, Plaintiff has filed with defendant, pursuant to the terms of said policy, numerous claims for payment relating to medical treatment, doctors and hospital charges, and other covered expenses on behalf on of both himself and his spouse, now deceased.

6. Plaintiff avers that during the period October 1, 1982 through the time of filing of this complaint, the defendant has willfully and intentionally and fraudulently, as a part of the deliberate plan or scheme, (a) failed to pay many claims of the

plaintiff from funds available to it, or in the custody or control from the Alabama State Employees Health Insurance Plan Fund, and further,

(b) in many instances, if the defendant did pay a claim at all, it did not pay the claim in full and failed and refused to pay the said claim in full and further,

(c) in many instances, if the defendant did pay the claim at all, in whole or in part, it paid the claim in a very late and untimely manner and only after unreasonable delay.

(d) Plaintiff further avers that the defendant, Blue Cross/Blue Shield of Alabama, as a conscious, willful and intentional and fraudulent plan or scheme, has withheld payment of valid claims for unreasonable lengths of time and in so doing, unlawfully enriched itself by investment of the money wrongfully withheld by it. Plaintiff avers that the said actions of defendant as set forth hereinabove of unreasonably delaying payment of valid claims and failure to pay valid claims in full within a reasonable time has injured the Plaintiff and others similarly situated, has caused the plaintiff and others similarly situated to suffer embarrassment and humiliation by being unable to promptly pay doctors, hospitals, pharmacies, and other medical services.

7. Plaintiff further avers that the defendant, Blue Cross/Blue Shield of Alabama, has a master contract with the Alabama State Employees Health Insurance Plan, to wit, Group Number 13000. Plaintiff avers that the defendant, Blue Cross/Blue Shield of Alabama, has charged premiums to the State of Alabama, through the Alabama State Employees Health Insurance Plan, based upon the actual charges made by health care providers for the various services, treatment and supplies charged by those providers. Plaintiff further avers that even though the defendant, Blue Cross/Blue Shield of Alabama, bases its premium charge to the Alabama State Employees Health Insurance Plan on the actual charges of medical providers for their various services, that Blue Cross/Blue Shield of Alabama has a policy or custom of paying to medical

providers only those charges for various medical services which the defendant, in its unilateral discretion, has deemed to be "reasonable", regardless of the actual charges of the provider. Plaintiff avers that the aforesaid conduct of the defendant has proximately resulted in the Alabama State Employees Health Insurance Plan paying excessive charges to the defendant and causing the said Plan to pay excessively high premiums on behalf of the employees of the State of Alabama and causing these employees, including the plaintiff, who carry dependent coverage pursuant to the said policy, to pay excessively high premiums for the medical insurance coverage.

8. Plaintiff avers that the defendant has acted in bad faith in its breach of the master contract, Group Number 13000, with the Alabama State Employees Health Insurance Plan.

Causes of Action

Count I

9. Plaintiff hereby adopts and incorporates by reference each and every allegation of the preceding paragraph as if fully set out herein.

10. Plaintiff avers that the defendant has breached an agreement with Plaintiff and other members of the class by:

a) Failing to pay valid claims of plaintiff and those of other members of the said class pursuant to the terms of the master contract between defendant and the State of Alabama;

b) Failing to pay valid claims of the plaintiff and those of other members of the class in full;

c) Failing to pay the claims of the plaintiff and those of other members of the class within a reasonable time and in delaying payment of valid claims for an unreasonable length of time.

d) Charging premiums to the State of Alabama based on the actual charges of medical providers while maintaining

a policy of paying only a portion of those actual charges to health care providers.

3. Plaintiff avers that as a direct and proximate result of the allegations as set forth hereinabove, plaintiff, and others have been injured and damaged and that the Alabama State Employees Health Insurance Fund has been injured and damaged.

Count II

11. Plaintiff hereby adopts and incorporates by reference each and every allegation of the preceding paragraphs as if fully set out herein.

12. Plaintiff avers that there is no lawful basis for the actions of defendant, to wit, in

(a) Refusing to pay valid claims of the plaintiff, and those of other members of the class;

(b) Refusing to pay in full valid claims of the plaintiff and those of other members of the class;

(c) Refusing to pay valid claims of the plaintiff and other members of the class in a timely manner.

(d) Having a policy or custom of failing and refusing to pay valid claims submitted to it under Group Policy 13000, refusing and failing to pay claims submitted under Group Policy 13000 in full, and in refusing to pay valid claims under Group Policy 13000 in a timely manner and in making any payments that are made in whole or in part, only after unreasonable delay. The plaintiff further avers that the defendant, its agents and employees, knew and have known that there is no lawful basis for refusing or failing to pay the valid claims of plaintiff and other members of the class within a reasonable time pursuant to the said group policy; that the defendant, its agents and employees, knew that there was no lawful basis for refusing or failing to pay the claims of plaintiff and those other members of the class herein in full; and further, that the defendant, its agents and employees knew and have known that there is no

lawful basis for refusing or failing to pay plaintiff's claims and those submitted by other members of the class herein.

(e) Having a policy or custom of charging premiums to the State of Alabama for Group Policy 13000 based on the actual charges of health care provided while intentionally paying claims, when or if they are paid at all, only in an amount deemed "reasonable" by defendant and paying in claims only a portion of the said actual charges.

13. Plaintiff avers that the defendant has committed the tort of bad faith in its dealings with the plaintiffs and with other members of the class as defined hereinabove. Plaintiff further avers that the defendant has acted in bad in failing and refusing to pay to plaintiff and other members of the class the benefits to which they are entitled pursuant to the insurance policy or contract, by refusing to pay valid claims in a timely manner, by refusing to pay valid claims in full, and in exercising a policy or course of conduct whereby it refuses to pay valid claims, in whole or in part, submitted by members of the class herein and when it does pay any claims, in whole or in part, pays them in such an unreasonably delayed fashion as to cause plaintiff herein and other members of the class great humiliation and embarrassment; and that as a direct and proximate result of the actions of defendant as set out hereinabove, plaintiff and other members of the class as defined hereinabove have been damaged and injured.

Relief Requested

Plaintiff prays that this Court will, as soon as practical, enter an order certifying this class as a class action pursuant to Rule 23, Alabama Rules of Civil Procedure.

a) Award to Plaintiff, and other members of the class herein, compensatory damage for breach of contract, inconvenience, emotional and mental distress, disappointment, pain and suffering.

b) That this court will award to plaintiff and other members of the class punitive damages for defendant's bad faith breach of contract;

c) That this court will award to plaintiff costs of this proceeding, a reasonable attorney's fee and such other and further relief as the court deems just and proper.

W. Eugene Rutledge
Attorney for Plaintiff

Of Counsel:

Rutledge and Associates
1300 Brown Marx Tower
2000 First Avenue North
Birmingham, Alabama 35203
Telephone: (205) 322-8761

Jury Demand

Plaintiff demands a trial by jury on all issues triable to a jury.

W. Eugene Rutledge

Plaintiff's Address

3609 Spring Hill Road
Birmingham, AL 35223

Serve Defendant At:

Blue Cross/Blue Shield of Alabama
c/o William Mandy, President
450 Riverchase Parkway, East
Birmingham, Alabama 35298

THE STATE OF ALABAMA
Jefferson County

Circuit Court,
Tenth Judicial Circuit of Alabama
In Equity

I, the undersigned, as Register of the Circuit Court, Tenth Judicial Circuit of Alabama, do hereby certify that the foregoing contains a full, true and correct copy of the instrument herewith set out as appears of record in said Court.

Witness my hand and seal of said Court, this the 20th day of February, 1985.

_____, Register.

By:_____
Deputy Register.

State of Alabama Unified Judicial System C5-JC	CASE ACTION SUMMARY — CIVIL —	CASE NUMBER CV 84 500-447 JDC ID YR NUMBER JUDGE

IN THE CHANCERY COURT
OF JEFFERSON COUNTY

PLAINTIFF(S)	DEFENDANT(S)
T. Eric Embry	Blue Cross/Blue Shield of Alabama

CASE NUMBER	AMOUNT	DATE FILED
CV 84 500-447 JDC	57.00	1/30/84

ATTORNEY(S) FOR PLAINTIFF(S)	ATTORNEY(S) FOR DEFENDANT(S)
W. Eugene Rutledge & Clyde E. Riley of Rutledge, Fay & Kelly, P.C.	Henry E. Simpson and William S. Somerville, Jr. of Lange, Simpson, Robinson & Somerville

DATE	ACTIONS, JUDGMENTS, CASE NOTES
1/30/84	Comp. Seeking Declaratory Judgment
1/31/84	Sum. & Comp. iss'd. 2/2/84 Exl 2/3
3/2/84	Mot. to Dismiss & Notice (SBA) (3/5)
4/11/84	Order of Continuance (JDC) (4/16)
5/31/84	Order (JDC) (6/7)
10/2/84	Notice of Depo (SBA) (10/3)
11/14/84	Motion to Compel & Notice (SBA) (11/15)
11/19/84	Order (JDC) (11/26)
11/21/84	P's Motion to Certify the Action as a Class Action
11/21/84	Notice of Hearing (11/20)
12/7/84	D's Answer to Pl. Interr. (SBA) (12/10)
12/12/84	Response to P's Request for Production (SBA) (12/11)
12/13/84	Motion to Compel (SBA) (12/14)
12/13/84	Notice of Hearing (12/14)
12/17/84	Notice of Depo (SBA) (12/18)
12/19/84	Depo of E. Gene Thresher (12/20)
12/20/84	Order on Motion to Compel (JDC) (12/16)
2/21/84	Memorandum of Plaintiff (SBA) (12/20)
1/4/85	P's Motion for a Protective Order (SBA) (1/16)
1/7/85	D's Supplemental Answer to P's Interr. (SBA) (1/10)
1/7/85	Motion for Protective Order & Notice (SBA) (1/10)
1/9/85	Order (JDC) (1/10)
1/9/85	Order Re: Class Certification Hearing (JDC) (1/10)
1/14/85	Order of Continuance (JDC) (1/10)

THE STATE OF ALABAMA
Jefferson County

Circuit Court,
Tenth Judicial Circuit of Alabama
In Equity

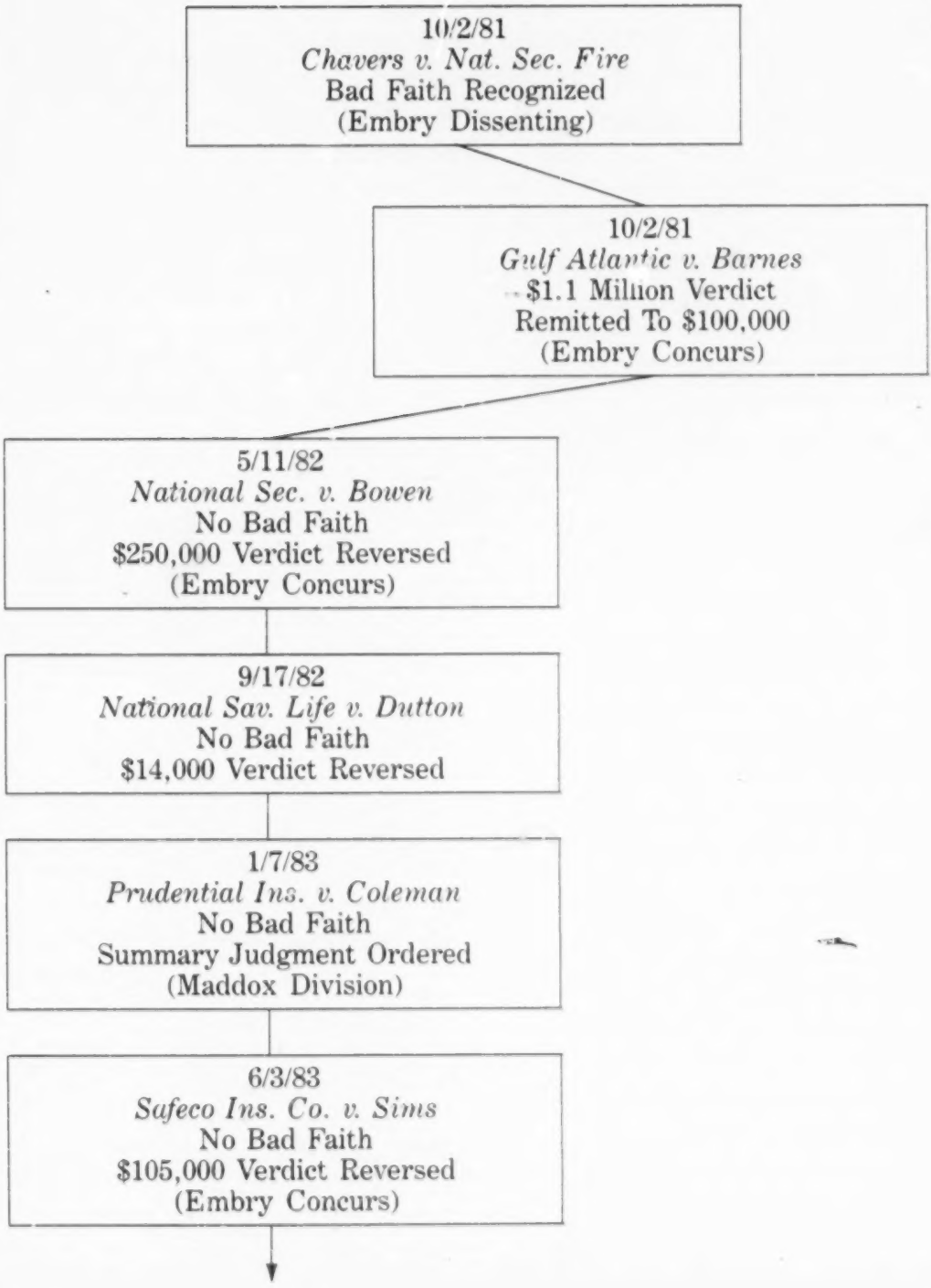
I, the undersigned, as Register of the Circuit Court, Tenth Judicial Circuit of Alabama, do hereby certify that the foregoing contains a full, true and correct copy of the instrument herewith set out as appears of record in said Court.

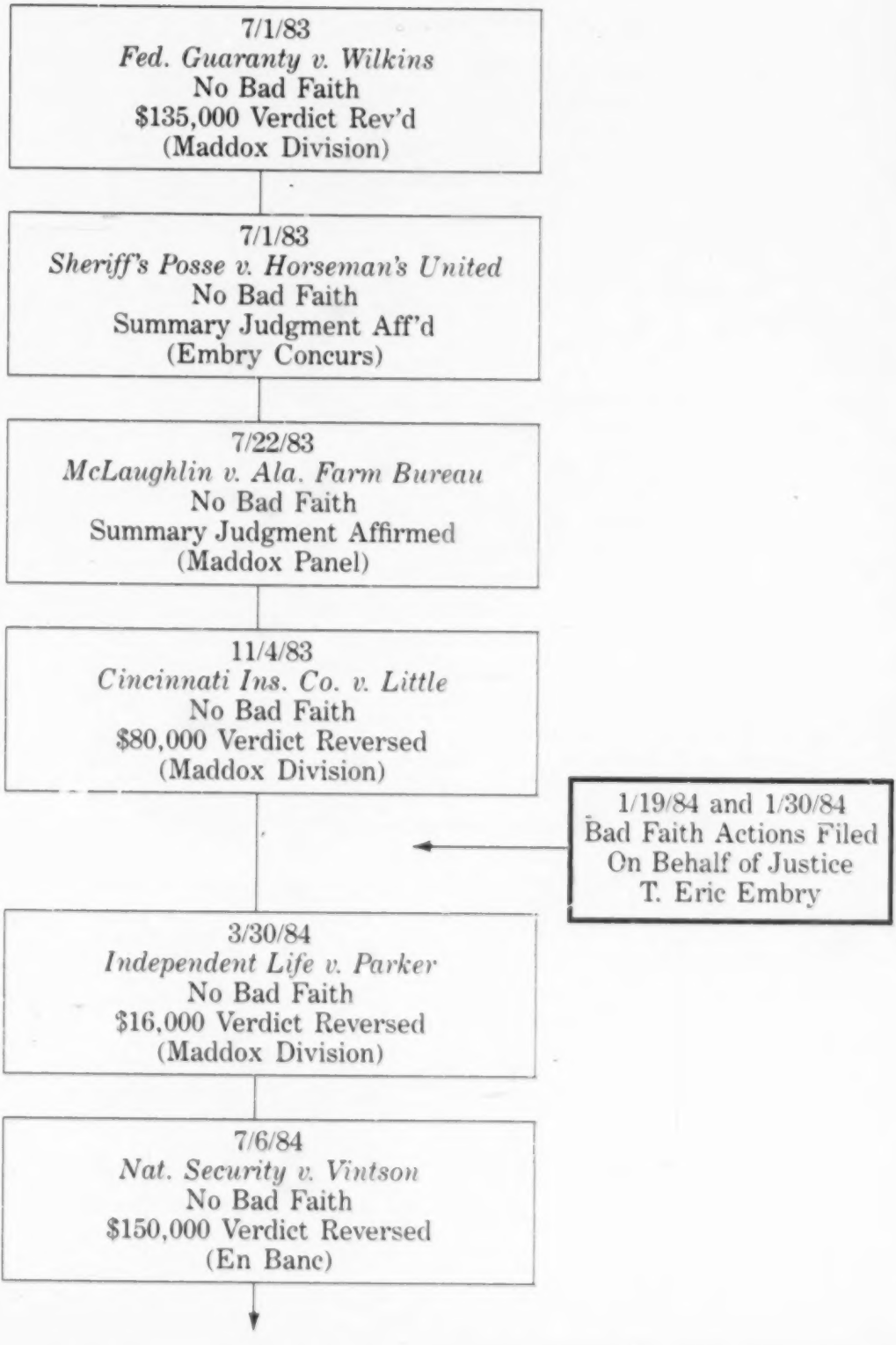
Witness my hand and seal of said Court, this the 20th day of February, 1985.

_____, Register.

By:_____
Deputy Register.

EXHIBIT C


10/2/81
Chavers v. Nat. Sec. Fire
Bad Faith Recognized
(Embry Dissenting)
10/2/81
Gulf Atlantic v. Barnes
$1.1 Million Verdict
Remitted To $100,000
(Embry Concurs)
5/11/82
National Sec. v. Bowen
No Bad Faith
$250,000 Verdict Reversed
(Embry Concurs)
9/17/82
National Sav. Life v. Dutton
No Bad Faith
$14,000 Verdict Reversed
1/7/83
Prudential Ins. v. Coleman
No Bad Faith
Summary Judgment Ordered
(Maddox Division)
6/3/83
Safeco Ins. Co. v. Sims
No Bad Faith
$105,000 Verdict Reversed
(Embry Concurs)


7/1/83
Fed. Guaranty v. Wilkins
No Bad Faith
$135,000 Verdict Rev'd
(Maddox Division)
7/1/83
Sheriff's Posse v. Horseman's United
No Bad Faith
Summary Judgment Aff'd
(Embry Concurs)
7/22/83
McLaughlin v. Ala. Farm Bureau
No Bad Faith
Summary Judgment Affirmed
(Maddox Panel)
11/4/83
Cincinnati Ins. Co. v. Little
No Bad Faith
$80,000 Verdict Reversed
(Maddox Division)
1/19/84 and 1/30/84
Bad Faith Actions Filed
On Behalf of Justice
T. Eric Embry
3/30/84
Independent Life v. Parker
No Bad Faith
$16,000 Verdict Reversed
(Maddox Division)
7/6/84
Nat. Security v. Vintson
No Bad Faith
$150,000 Verdict Reversed
(En Banc)

8/31/84
Payne v. Nationwide Mut.
No Bad Faith
Summary Judgment Aff'd
("All the Justices Concur")

12/7/84
Aetna Fire v. Lavoie
$3.5 Million Bad Faith Verdict *Affirmed*
(Embry in 5-4 Majority)

12/21/84
Tyson v. Safeco Ins. Co.
No Bad Faith
Summary Judgment Aff'd
(Maddox Division)

12/21/84
Continental Assur. v. Kountz
$23,000 Bad Faith Verdict Aff'd
(Embry Concurs)

12/21/84
Blue Cross v. Granger
No Bad Faith
$500,000 Verdict Reversed
(Embry Recused)

2/8/85
Nationwide v. Clay
$1.25 Million Bad Faith Verdict
Affirmed
(Embry Concurs)

EXHIBIT D

IN THE
SUPREME COURT OF ALABAMA

Case Number 82-536
82-917

NATIONWIDE MUTUAL INSURANCE COMPANY,
Appellant,

v.

HENRY GERRARD CLAY,
Appellee.

AFFIDAVIT

Before me the undersigned authority appeared BERT S. NETTLES who, being first duly sworn, did depose and say as follows:

My name is Bert S. Nettles. I am a duly licensed and practicing attorney in the State of Alabama. I am the lead attorney for the appellant Nationwide Mutual Insurance Company in this action. The first knowledge I had of Associate Justice T. Eric Embry's seeking bad faith damages as a plaintiff in lawsuits against insurance companies was obtained on Thursday morning, February 14, 1985. I am informed and believe and, based upon such information and belief, I state that prior to that time no such knowledge was possessed or had been obtained by any other lawyer in this law firm or by Nationwide Mutual Insurance Company.

BERT S. NETTLES, Affiant

Subscribed and sworn to before me
this 22nd day of February, 1985.

NOTARY PUBLIC
My Commission expires 10-6-86.

APPENDIX D

IN THE
SUPREME COURT OF ALABAMA

Case Number 82-536
82-917

NATIONWIDE MUTUAL INSURANCE COMPANY,
Appellant,

v.

HENRY GERRARD CLAY,
Appellee.

Filed
Feb. 27, 1985
Clerk
Supreme Court of Alabama

AMENDMENT TO MOTION FOR WITHDRAWAL OF OPINIONS AND SUGGESTION OF DISQUALIFICATION

Comes now appellant Nationwide Mutual Insurance Company ("Nationwide") and amends its Motion captioned "MOTION FOR WITHDRAWAL OF OPINIONS AND SUGGESTION OF DISQUALIFICATION" that was filed in this cause on February 22, 1985, to include the following additional ground:

> 19. Nationwide has been denied due process of the law in violation of both the Constitution of the United States of America and the Constitution of Alabama of 1901.

BERT S. NETTLES

FORREST S. LATTA
Attorneys for Appellant and Movant Nationwide Mutual Insurance Company

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Oral argument en banc is requested on this amendment as well as Nationwide's principal motion of February 22, 1985. As stated in the original motion, this is a case of first impression. It is a uniquely serious situation certainly warranting oral argument before this Court en banc.

BERT S. NETTLES

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Amendment to Motion upon Counsel for Appellee, Fred W. Killion, Jr., Esquire, Post Office Box 8158, Mobile, Alabama 36608, by placing a copy of same in the United States Mail, postage prepaid. Similar service has been made upon counsel of record in *Lavoie* and in *Kountz*.

Dated this 26th day of February, 1985.

BERT S. NETTLES

APPENDIX E

In The
Supreme Court of Alabama

Case Number 82-536
82-917

NATIONWIDE MUTUAL INSURANCE COMPANY,
Appellant,

v.

HENRY GERRARD CLAY,
Appellee.

Appeal From The Circuit Court
For The Thirteenth Judicial Circuit of Alabama
(Mobile County)

Application for Rehearing of Nationwide Mutual Insurance Company and Brief in Support Thereof

---

Oral Argument Requested (En Banc)

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Of Counsel:

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STATEMENT IN SUPPORT OF REQUEST FOR ORAL ARGUMENT

Due to the unique seriousness of the disqualification issues raised, and the significance of this bad faith affirmance (the first affirmance of a "first tier" bad faith verdict since *Great Atlantic v. Barnes*), Nationwide submits that this Application for Rehearing warrants oral argument before this Court *en banc*.

TABLE OF CONTENTS

STATEMENT IN SUPPORT OF ORAL ARGUMENT i

TABLE OF AUTHORITIES iv

APPLICATION FOR REHEARING 1

ARGUMENT IN SUPPORT OF APPLICATION FOR REHEARING 5

I. The award of an amount less than full contract benefits demonstrates the Court's error in holding that Nationwide's contract defenses were groundless 5

II. Is an insurance company now precluded from debating the existence of an ambiguity in its policy? 9

III. The court has erred by applying the wrong standard of review with respect to the directed verdict against Nationwide 11

IV. Even assuming the trial court correctly ruled there was not a scintilla of evidence supporting Nationwide, there were numerous legal defenses negating bad faith as a matter of law 16

V. There was insufficient evidence that Nationwide had "actual knowledge" that it had no arguable basis for withholding further benefits 19

VI. The trial court's ruling, and majority's affirmance, creates an improper incentive for a policyholder to withhold material facts from an insurance company 23

VII. The punitive damage award—a proposed solution to the error 26

VIII. Mr. Justice Embry's personal interest in shaping the law of bad faith renders this Court's decision illegal as violative of Nationwide's Fifth and Fourteenth Amendment due process rights under the U.S. Constitution 33

Table of Contents Continued

Page

IX. The majority's application of the law in this case, and its affirmance of the $1.25 million dollar punitive damage verdict, has deprived Nationwide of certain rights under the United States Constitution 36

CONCLUSION 39

CERTIFICATE OF SERVICE 40

APPENDIX

Affidavit of Stephen A. Rish, Associate Vice President, Nationwide Mutual Insurance Company A-1

First State Ins. Co. v. Wallace, No. 83-7206, Slip op. (11th Cir. March 6, 1985) A-2

Excerpt from "Reply Brief of Henry Gerrard Clay, Plaintiff, in Opposition to the Defendant's Motion for Partial Summary Judgment" A-10

TABLE OF AUTHORITIES

Page

Aetna Life & Cas. Ins. Co. v. Lavoie, 19 ABR 271, ____ So.2d ____ (Dec. 7, 1984) 1, 3, 4, 18, 32

Antram v. Stuyvesant Life Ins. Co., 291 Ala. 716, 287 So.2d 837 (1973) 9

Aspinwall v. Gowens, 405 So.2d 134 (Ala. 1981) 29

Blue Cross & Blue Shield v. Granger, 19 ABR 444, ____ So.2d ____ (Ala. Dec. 21, 1984) 19, 21, 22

Canal Ins. Co. v. Stidham, 281 Ala. 493, 205 So.2d 516 (1967) 10

Caterpillar Tractor Co. v. Ford, 406 So.2d 854 (Ala. 1981) 12

Chavers v. National Sec. Fire & Cas. Co., 405 So.2d 1 (Ala. 1981) 2, 19, 20, 21, 37

Continental Assur. Co. v. Kountz, 19 ABR 462, ____ So.2d ____ (Dec. 21, 1984) 1, 3, 4, 18, 32

First State Ins. Co. v. Wallace, No. 83-7206, Slip op. (11th Cir. March 6, 1984) 8

Frank v. Mangum, 237 U.S. 309, 59 L.Ed. 969, 35 S.Ct. 582 (1915) 36

Gulf Atlantic Life Ins. Co. v. Barnes, 405 So.2d 916 (Ala. 1981) 1, 3, 19, 21, 27, 29, 37

Marks v. United States, 430 U.S. 188, 51 L.Ed.2d 260, 97 S.Ct. 990 (1977) 36, 37

Maryland Cas. Co. v. Allstate Ins. Co., 281 Ala. 671, 207 So.2d 657 (1968) 10

In re Murchison, 349 U.S. 133, 99 L.Ed. 942, 75 S.Ct. 623 (1955) 33, 34, 35

National Sav. Life Ins. Co. v. Dutton, 419 So.2d 1357 (Ala. 1982) 14

Prudential Ins. Co. v. Coleman, 428 So.2d 593 (Ala. 1983) 19, 21

Safeco Ins. Co. v. Sims, 435 So.2d 1219 (Ala. 1983) ... 17

Table of Authorities Continued

	Page
Smith v. Kennesaw Life & Acc. Ins. Co., 284 Ala. 12, 221 So.2d 372 (1969)	10
Trinity Universal Ins. Co. v. Robert P. Stapp, 278 Ala. 209, 177 So.2d 102 (1963)	10
Turner v. Peoples Bank, 378 So.2d 706 (Ala. 1979)	11, 12, 15
STATUTES AND RULES	
Alabama Code § 27-14-7 (1975)	16,36
Alabama Rules of Civil Procedure Rule 50(e)	12
MISCELLANEOUS	
Keeton, *Hornbook on Insurance Law* § 1.4 (West 1971)	27
Prosser, *The Law of Torts* § 2 (4th Ed. 1971)	30
Webster's New World Collegiate Dictionary, (1981)	21

APPLICATION FOR REHEARING

The majority's affirmance of the $1.25 million dollar verdict in this case constitutes the first "first tier" bad faith verdict to be affirmed in this state since *Gulf Atlantic Life Ins. Co. v. Barnes*, which was announced on the same day (October 2, 1981) the tort of bad faith was first recognized in Alabama. Since then, no fewer than eleven straight such cases were decided over a three year period in favor of insurance companies on the issue of bad faith. Even in *Barnes* the Court remitted the jury's $1.1 million dollar bad faith punitive damages verdict to $100,000 with the observation that such verdict was "obviously" the result of passion and prejudice.

Suddenly, however, a majority of this Court has announced three bad faith affirmances in the last two months involving verdicts of $4.3 million dollars (*Aetna v. Lavoie*), $23,000 (*Continental Assurance v. Kountz*), and now $1.25 million dollars (*Nationwide v. Clay*). No rhyme or reason is offered to justify the tremendous disparity in the three damage awards, or to reconcile them with the Court's remittitur in *Barnes*. Furthermore, while *Lavoie* and *Kountz* cases were characterized as "extreme" cases, thereby justifying a suspension of the normal directed verdict standard, the instant case falls under the first tier of the test enunciated in *Chavers v. National Sec. Fire Ins. Co.* Therefore, the usual standards apply, requiring all of the traditional elements of the tort of bad faith in proving that Nationwide had absolutely no legal or factual defense coupled with actual knowledge of that fact. In that regard, it is submitted that the majority has seriously erred by overlooking, or ignoring, several legitimate factual and legal arguments asserted by Nationwide in its contract dispute with Clay. Foremost among those overlooked issues is the fact that the contract award was less than the amount claimed by Clay under his policy of Nationwide disability insurance. This result was due to Nationwide's defense that Clay was not entitled to full benefits under the Relation of Earnings to Insurance clause. Yet, the bad faith claim still went to the jury.

Nationwide also asserted a legitimate legal argument (in connection with its defense of misrepresentation in the applica-

tion) that no ambiguity existed in the question concerning Clay's earnings. These issues, and others, are discussed more fully in the following brief.

One of the more troublesome aspects of this present situation involves the sudden and inexplicable change of course demonstrated in this case, as well as *Lavoie* and *Kountz*, concerning the tort of bad faith. Whereas last fall the trial bench and bar (plaintiffs' and defense lawyers alike) were of the consensus that the tort of bad faith had been narrowed to a point where it was doubtful that another bad faith verdict would ever be affirmed, suddenly it is blown wide open. Million dollar punitive damage verdicts once considered obviously the product of jury passion are now affirmed without remittitur, and without any explanation or rationale for the departure from the *Barnes* standard on remittitur.

Furthermore, and perhaps even more significantly in this case, the tort of bad faith has been expanded to encompass mere "uncooperative, intransigent behavior," as the majority in the instant case has so characterized Nationwide's conduct. The majority has obviously departed from the Court's earlier holdings that bad faith is a remedy to be applied only in the most extreme cases involving blatant and malicious refusals to pay without any arguable basis. The $1.25 million dollar affirmance is almost beyond comprehension in view of the less-than-extreme circumstances involved in this case, especially considering the legitimate legal and factual arguments asserted by Nationwide. It appears the majority of this Court is simply following the rationale that any "bad faith" jury award not set aside by the trial judge will be affirmed (at least up to $3.5 million dollars, and possibly more).

In any event, due to the significance of this "first tier" bad faith affirmance (a different species from *Lavoie* or *Kountz*), and the unusually large punitive damage verdict, Nationwide hereby submits this application for rehearing. The following brief specifically points out the errors committed by the majority in reviewing this case, and also raises certain questions of a

highly and uniquely serious nature involving the fairness and impartiality with which this case was decided. It is respectfully submitted that Nationwide is entitled to a full rehearing, that the original majority opinion should be withdrawn, and that at the very least the bad faith judgment against Nationwide should be reversed.

ARGUMENT IN SUPPORT OF APPLICATION FOR REHEARING

I. The Award of an Amount Less Than Full Contract Benefits Demonstrates the Court's Error in Holding That Nationwide's Contract Defenses Were Groundless.

Under the majority holding, even if an insurer asserts a legitimate defense on the contract as to the amount of coverage owed, and *wins* on that issue, the bad faith claim will still go to the jury. That result flies in the face of the previous standard that a plaintiff must prove the insurer has "no legal or factual defense" before a bad faith claim can go to the jury.

It apparently is not clear to the majority that Clay wanted full contract benefits under his Nationwide disability income policy, regardless of his level of income or the existence of other disability policies. Through a motion in limine, Clay sought to exclude any evidence of his income and other policies, arguing that such evidence was irrelevant and immaterial to the issues. (CR 26) Furthermore, in his reply brief to Nationwide's motion for partial summary judgment on the bad faith issue, Clay vigorously asserted his entitlement to full contract benefits, stating in part as follows:

> The Plaintiff claims that under their contract he was entitled to $44,910 in total benefits and a premium waiver of $3,652.08 for a total of $48,562.08, not including interest. (See Appendix at A-10 through A-13)

Pre-judgment interest at 6% from the date of each payment would have brought the total contract award to well over $50,000 by the time of trial on December 13, 1982.

Nationwide, however, took the position that even if Clay was found not to have misrepresented facts on his application, he still was not entitled to full contract benefits under the Relation of Earnings to Insurance clause. Under that clause, Clay's benefits were due to be prorated according to his level of income and the amount of other disability income insurance he owned. In its Amended Answer filed April 27, 1982, Nationwide affirmatively alleged that Clay's level of earnings was insufficient to allow him to receive full benefits under the policy. (CR 44—FOURTH DEFENSE) Nationwide further alleged that any benefits due Clay were to be prorated with his other disability insurance policies. (CR 44—FIFTH DEFENSE) Thus, there was a sharply disputed legal and factual issue over the *amount* of benefits due Clay, if any.

On December 17, 1982, the trial court directed a verdict for Clay on the contract claim in the amount of $46,165. In so doing, the court awarded an amount less than full contract benefits by computing Clay's contract award under the Relation of Earnings to Insurance clause. Although the actual work papers used by the trial court were not preserved in the record, counsel for Clay assisted the trial court in computing the contract award and has illustrated in the Appellee's brief the manner in which the contract benefits were prorated. (Clay brief 130-32) By applying the Relation of Earnings to Insurance clause to award Clay an amount less then he claimed, the trial court essentially adopted Nationwide's defenses concerning the amount of coverage owed. Why, then, in view of this obviously legitimate legal and factual defense to the contract claim, was the bad faith claim sent to the jury? That question has yet to be answered by the trial court, by Clay himself, and now by the majority in its opinion.

The majority mentions that Nationwide did not object to the trial court's computations after the plaintiff's motion for directed verdict was granted. Unfortunately, the majority seems to have missed the point of this argument. The trial court, by prorating the contract claim, was in effect recognizing the merit of Nationwide's contract defenses (the FOURTH and

FIFTH DEFENSES, CR 44). Therefore, *on that basis alone, even if there had been no other debatable defenses*, the trial court erred in submitting the bad faith claim to the jury. Ample objection was taken to submission of the bad faith claim. It is respectfully submitted that the majority's suggestion that Nationwide should have objected to the trial court's method of computation simply illustrates its misunderstanding of this issue.

Until now, controversies over the *amount* of coverage decided favorably to the insurer illustrated, as a matter of law, that the insurance company had a legitimate defense to the contract claim and negated any issue of bad faith. *See, e.g., First State Ins. Co. v. Wallace*, No. 83-7206, March 6, 1984 (11th Cir. 1984) (applying Alabama law). A copy of the *Wallace* decision is appended hereto at A-2. In *Wallace*, as in the present case, the plaintiff was awarded contract benefits in an amount less than he had claimed. The trial court then held that First State was entitled to judgment as a matter of law on the bad faith count due to the fact issue involving the *amount* of liability. That decision was affirmed by a panel of the Eleventh Circuit Court of Appeals. Surely this is still the law, and the majority has erroneously overlooked this key point.

II. Is an Insurance Company Now Precluded from Debating the Existence of an Ambiguity in its Policy?

Depending upon the meaning of the term "average earned monthly income" in Nationwide's application, Clay arguably misrepresented his income in applying for disability income coverage. Nationwide contended that the term "average earned monthly income" meant Clay's gross pay *after* office expenses. Clay argued it meant his gross law office receipts *before* overhead expenses. The trial court ruled that the phrase was ambiguous and construed it in favor of Clay.

Nationwide recognizes it was the trial court's province to determine the existence of an ambiguity and construe it liberally for the insured. However, until that time, it was an open and debatable question. The mere fact that adverse parties

contend for different constructions of a policy provision does not of itself force a conclusion that disputed language is ambiguous. *Antram v. Stuyvesant Life Ins. Co.*, 291 Ala. 716, 720, 287 So.2d 837 (1973). In fact, there are scores of cases in which the courts have ruled against policyholders on the existence of an ambiguity. *See, e.g., Smith v. Kennesaw Life & Acc. Ins. Co.*, 284 Ala. 12, 221 So.2d 372 (1969); *Maryland Cas. Co. v. Allstate Ins. Co.*, 281 Ala. 671, 207 So.2d 657 (1968); *Canal Ins. Co. v. Stidham*, 281 Ala. 493, 205 So.2d 516 (1967); *Trinity Universal Ins. Co. v. Robert P. Stapp*, 278 Ala. 209, 177 So.2d 102 (1963). The existence of an ambiguity was debatable, and Nationwide was entitled to debate it.

Furthermore, as the Court has often observed, the "polestar" of all rules of construction is the intent of the parties. *Smith v. Kennesaw Life & Acc. Ins. Co.*, 284 Ala. at 18. In that regard, Nationwide introduced its agent's portfolio, which was at least a "scintilla" of evidence concerning the parties' intent regarding the meaning of the term "average earned monthly income." This point is acknowledged in the dissenting opinion of Justice Maddox. Nationwide attempted to further develop evidence concerning the parties' intent until this issue was foreclosed by the trial court even while Clay was still on the stand and before Nationwide could present its case. (RT. 234-43) Clay was an experienced lawyer, trained and knowledgeable regarding the meaning and importance of such questions on disability income applications. At the very least, there was a scintilla of evidence supporting Nationwide's assertion of fact concerning the parties' intentions as to the meaning of "average earned monthly income," and the jury could have resolved that issue favorably to Nationwide. On that basis alone, the contract claim should have gone to the jury.

As it now stands, the majority's holding signifies that an insurance company can no longer debate the existence of an ambiguity without subjecting itself to a bad faith claim if the issue is decided favorably to the insured. Nor is a company entitled to a jury determination of the fact issue involving what the parties intended by certain terminology in the application.

Nationwide submits that this holding cannot be correct, and the majority opinion should be withdrawn in favor of a holding that Nationwide did have a legal or factual defense involving the earnings question in Clay's policy.

III. The Court Has Erred By Applying the Wrong Standard of Review With Respect to the Directed Verdict Against Nationwide.

In *Turner v. Peoples Bank*, 378 So.2d 706 (Ala. 1979), this Court stated that a directed verdict is proper on a claim only where the facts are such that all reasonable men must draw the same conclusion. *Id.* at 709. If the slightest gleam, glimmer or trace of evidence supports an inference in favor of the non-moving party, the claim *must* go to the jury. *Id.* Also, it is clear that "a defendant as well as a plaintiff is entitled to the benefit of the scintilla rule." *Id.* (citations omitted) Applying those principles in this case, the very fact of Justice Maddox's dissent on the contract issue illustrates that all reasonable men to not draw the same conclusion.

Rule 50(e) expressly states that the standard for directing a verdict is the "scintilla rule." Accordingly, the appellate court's duty in reviewing the propriety of a directed verdict is to view the evidence in a light most favorable to the non-moving party, regardless of the Court's view as to the weight of that evidence. *Caterpillar Tractor Co. v. Ford*, 406 So.2d 854, 856 (Ala. 1981). It is respectfully submitted that the majority has erred on a matter of basic procedure by failing to adhere to that standard. In reviewing the trial court's directed verdict on the contract claim, the majority should have focused upon the evidence presented by Nationwide rather than dwelling upon Clay's version of the disputed testimony. The majority opinion, however, repeatedly quotes and paraphrases Clay's testimony and ignores the evidence adduced by Nationwide.

For example, the majority fails to address the issue of fact concerning the boldly printed warning in Clay's Nationwide policy that he should notify the company of any incorrect information contained in his policy application. (RT 203) It was

undisputed that Clay represented he would terminate his Paul Revere coverage if the Nationwide policy was issued. However, by the time Clay received his Nationwide policy, containing the language of caution, Clay knew he had substantially increased his Paul Revere coverage. As stated earlier, Clay was not the average insurance applicant. Being a lawyer, he possessed special knowledge of the significance of his representation that the Paul Revere coverage would be cancelled. Yet he substantially increased his coverage with Paul Revere, and admitted in court that he knew he had "too much coverage." (RT 209; 141) An issue of fact therefore existed as to whether Clay made a misrepresentation by failing to notify Nationwide that he had retained and increased his Paul Revere coverage.

As this Court will recall, a nearly identical issue was presented in *National Sav. Life Ins. Co. v. Dutton*, 419 So.2d 1357 (Ala. 1982). In *Dutton* the insured's disregard of such cautionary language was sufficient to warrant reversal of a bad faith verdict. Is that reason no longer considered sufficient to even constitute an "arguable" basis of law or fact for contesting coverage? Nationwide submits that the majority overlooked this issue in the unusually lengthy record and briefs.

A further issue of fact involved the amount of benefits to which Clay was entitled. As previously mentioned, Clay contended he was entitled to full contract benefits, whereas Nationwide argued that Clay's benefits were due to be prorated under the Relation of Earnings to Insurance clause. On that fact issue, the trial court obviously ruled in favor of Nationwide. (See Section I, *supra*) There also existed a material factual dispute over computing the amount of Clay's income, and over whether the increased Paul Revere coverage was actually a new policy or an upgrading of his old policy. Furthermore, with due respect, it is urged that any construction of the term "average earned monthly income" involved a question of the parties' intentions, on which Nationwide was precluded from introducing any evidence other than the agent's portfolio.

This Court, in addressing situations wherein a directed verdict is entered against a plaintiff, has always had an over-

whelming tendency to give a plaintiff the benefit of any doubt by recognizing the slightest scintilla of evidence to enable the plaintiff to reach the jury. In the present case, however, the Court's tendency to ignore the evidence adduced by Nationwide is equally overwhelming. One shudders to suggest the Court has applied a double standard under the scintilla rule—one standard for individual plaintiffs, and another standard for defendant insurance companies. However, that is the inescapble conclusion to be drawn from the majority decision as it now stands. The Court in *Turner v. Peoples Bank*, *supra*, stated that the scintilla rule applies with equal force to benefit defendants as well as plaintiffs. 378 So.2d at 709. It is respectfully submitted that the Court either erred in misapplying this standard or that the various factual disputes were not considered by the majority.

IV. Even Assuming the Trial Court Correctly Ruled There Was Not a Scintilla of Evidence Supporting Nationwide, There Were Numerous Legal Defenses Negating Bad Faith As a Matter of Law.

In laying down the standard for letting a bad faith case go to the jury, this Court has repeatedly stated that the plaintiff must prove the insurer had "no legal or factual defense." Assuming for this argument that the trial court properly rejected all of Nationwide's factual defenses concerning misrepresentation and the amount owed, what about the "legal" defenses? Is it no legal defense to argue (successfully) that Clay wasn't entitled to the full contract benefits? Is it no legal defense to argue that there was no ambiguity with respect to the meaning of "average earned monthly income" and, therefore, that Clay's policy may be avoided for misrepresentation in the application under Ala. Code § 27-14-7 (1975)? Is it no legal defense to argue that Clay retained and upgraded his Paul Revere coverage after representing to Nationwide that he would terminate his Paul Revere coverage? Is it no legal defense to argue that Clay's policy is voided due to his failure to comply with the warning notice in his policy in connection with the Paul Revere coverage, which by then was renewed and substantially upgraded?

The very reference to "no legal *or* factual defense" contemplates cases wherein the insurer asserts legitimate legal defenses premised upon a factual dispute that is ultimately resolved in favor of the insured. *See Safeco Ins. Co. v. Sims*, 435 So.2d 1219, 1225 (Ala. 1983) (Jones, J., concurring specially). For example, consider the ambiguity issue in this case. There was a clear dispute of fact over whether Clay misrepresented his income in answering the question, "What is your average earned monthly income?" The trial court rejected Nationwide's defense that such language was not ambigious. Nevertheless, it was a legitimate legal defense. It was also a good factual defense since, under the scintilla of evidence adduced at trial (before the trial court excluded any further evidence on this issue), the jury could have adopted a meaning consistent with Nationwide's evidence and legal defense. (See Section II, *supra*)

Consider also Nationwide's defense concerning the amount of benefits due Clay. Clay wanted the full contract benefits, irrespective of the Relation of Earnings to Insurance clause. Nationwide asserted the legal defense that Clay wasn't entitled to full contract benefits, and the trial court agreed in computing the contract award. (See Section I, *supra*) That obviously constituted a good legal defense, but the bad faith claim still went to the jury.

If this were an extraordinary or "second tier" bad faith case like *Aetna Life & Cas. Ins. Co. v. Lavoie*, 19 ABR 271, ____ So.2d ____ (Dec. 7, 1984) or *Continental Assur. Co. v. Kountz*, 19 ABR 462, ____ So.2d ____ (Dec. 21, 1984), the Court's total disregard of Nationwide's legal defenses might make more sense. However, this is a "first tier" bad faith case, and the usual standards apply. Either the majority has retreated from the "no legal or factual defense" standard, or it simply overlooked these legal defenses in reading the briefs and record. It is respectfully submitted that the latter has occurred and therefore Nationwide urges that the original opinion be withdrawn and the bad faith judgment be reversed.

V. There Was Insufficient Evidence That Nationwide Had "Actual Knowledge" That it Had No Arguable Basis for Withholding Further Benefits.

In *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1 (Ala. 1981), this Court defined a "first tier" tort of bad faith as requiring proof that the insurer had "no lawful basis for the refusal coupled with actual knowledge of that fact." *Id.* at 7. The "actual knowledge" requirement was reaffirmed in *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916 (Ala. 1981), and has survived in the progeny of bad faith cases decided since then. The term "actual knowledge" implies a "conscious doing of wrong." *Id.* at 924. Consequently, the absence of any lawful basis, without more, does not constitute bad faith. For that reason, negligence (lack of due care) and bad judgment in handling direct claims have been held insufficient to warrant the imposition of punitive damages. *See Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d at 5; *Prudential Ins. Co. v. Coleman*, 428 So.2d 593, 598 (Ala. 1983); *Blue Cross & Blue Shield v. Granger*, 19 ABR 444, ____ So.2d ____ (Ala. December 21, 1984).

The evidence in the present case shows, if anything, that Nationwide believed it had an arguable basis for questioning Clay's claim for benefits on grounds that he had made misrepresentations in the policy application and that, in any event, he was not entitled to full contract benefits. On this latter ground, the trial court determined that in fact Clay was not entitled to full contract benefits. (See Section I, *supra*) How, then, could Nationwide have had actual knowledge of "no lawful basis" when the contract award itself shows that a legitimate ground for dispute did exist? Furthermore, Nationwide firmly believed it had a lawful basis for asserting the defense of misrepresentation in the application, even if such belief was held by the trial court to be mistaken. In *Chavers*, *supra*, Justice Almon observed that an insurer has a "lawful basis" whenever it has an honest but mistaken belief that a legitimate ground for refusal exists. 405 So.2d at 15. (Almon, J., dissenting) In the present

case, the record is totally devoid of any evidence indicating Nationwide consciously knew at the time this dispute arose that the term "average earned monthly income" would be judicially construed an ambiguity, thereby negating one of the misrepresentation arguments.

Nationwide respectfully submits that the majority in its opinion herein has erroneously departed from the standard requiring "no arguable basis" coupled with "actual knowledge" of that fact. Whereas the tort of bad faith has consistently been described as a remedy for the most "extreme" cases of malicious ill will and intentional refusal, now it has inexplicably been broadened to encompass what the majority herein describes merely as "uncooperative, intransigent behavior." *Nationwide Mutual Ins. Co. v. Clay*, M.S. at p. 24. *Compare Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d at 10; *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d at 925; and *Blue Cross & Blue Shield v. Granger*, 19 ABR at 456. Has the tort of bad faith suddenly become a remedy for occasional unreturned phone calls or an unwillingness to compromise? *Webster's New World Collegiate Dictionary* (1981) defines "intransigence" as "uncompromising" or "refusing to compromise." Since when, *until now*, was it a duty of the insurer to compromise a legitimate coverage dispute over a first party claim for coverage?

Previous bad faith cases teach that lengthy delays are not enough to constitute bad faith. *See, e.g., Prudential Ins. Co. v. Coleman, supra.* Neither are computer problems. *See, e.g., Blue Cross & Blue Shield v. Granger*, 19 ABR 444, 455 (December 21, 1984). As in *Granger*, much of the delay and confusion in this case was attributable to the fact that Nationwide's claim files (including Clay's) were being placed on computer, which required that the actual files be removed from their usual folders and kept temporarily at another location on a different floor. (RT. 768-79) While Nationwide fully acknowledges that Clay's claim was handled in less than exemplary fashion, such negligence, poor judgment or confusion does not rise to the level of malicious and oppressive intentional conduct for which the remedy of bad faith refusal to pay was created. Indeed, it is

significant that the majority *never* characterized Nationwide's handling of this claim as malicious and oppressive intentional conduct, but only as "uncooperative, intransigent behavior." It is respectfully submitted that the majority has suddenly and inexplicably attempted to broaden the scope of this "bad faith" tort remedy to encompass more than just a refusal to pay without any arguable basis.

In any event, there was no evidence that Nationwide had "actual knowledge" that it was without any debatable reason of law or fact in disputing Clay's claim for benefits. To the contrary, the result of the contract claim alone is evidence that a debatable reason did exist. Because of this error, the majority should withdraw its opinion and reverse the bad faith judgment.

VI. The Trial Court's Ruling, and Supreme Court's Affirmance, Creates an Improper Incentive for a Policyholder to Withhold Material Facts From an Insurance Company.

Under the majority's holding, once an insurance company requests further material information from an insured essential to a computation of his benefits, the insured can simply withhold such information and sue for bad faith. He can then further withhold that material information until two weeks before trial (or possibly even later) and, even if he isn't awarded the full contract benefits claimed, his bad faith count will go to the jury.

Not only is a company now forestalled from invoking the cooperation clause in requesting such information, but it may be subjecting itself to a bad faith claim merely because it requested further information. Clay has argued that he didn't believe Nationwide's statement that additional income information would effectively close the matter concerning Clay's claim for benefits. Therefore, Clay apparently contends he was excused from his duty to cooperate. However, while the insurance company's perceived "intransigent behavior" may excuse an insured from his duty under the cooperation clause, the

company's request for further information material to the claim should not be used as a vehicle for fashioning a bad faith claim. It is often that information received from other sources will raise questions that can only be answered from further information that must be obtained from the insured. In the present case, the circumstances giving rise to Nationwide's request for information verifying Clay's income developed gradually, and culminated in March, 1978, when Nationwide made a request for Clay's tax returns or other information reflecting his income. At the very least, this income information was necessary to compute the amount of benefits to which Clay was entitled. The majority, however, holds that this request was itself evidence of bad faith!

Consider the hypothetical wherein a life insurer, suspicious of suicide, requests further information concerning the circumstances of the insured's death. The insured had driven directly off a cliff near the road. The family angrily refuses to provide any further information and files suit. After several years of discovery, and only two weeks before trial, the insurance company (after numerous motions to compel) is finally furnished with a wreck analysis showing that the steering mechanism malfunctioned. Under the majority opinion in this case, the issue of bad faith would go to the jury.

There is no way Nationwide could have computed the benefits owed Clay without the income information obtained by court order two weeks before trial. This was the same income information sought in Nationwide's request of March 28, 1978. The reason Clay refused to furnish the income information, as shown in a motion in limine (CR 26) filed by Clay, was that he contended he was entitled to full contract benefits regardless of his income or other policies. That information, he argued, was irrelevant to the contract issue. The trial court, after ruling that Nationwide was entitled to discover Clay's income records for 1977, ultimately prorated Clay's contract benefits under the Relation of Earnings to Insurance clause by using that same income information, which had been withheld from Nationwide until two weeks before trial. (See Section I, *supra*) That fact

alone illustrates the merit of Nationwide's defense as to the amount of coverage owed, and implicitly acknowledges the reasonableness of Nationwide's request for income information.

Does an insurer act in bad faith by withholding further payment when the insured's refusal to cooperate makes it impossible to compute his benefits? Under this opinion, it would behoove any insured to withhold any requested information concerning his claim and simply sue for bad faith. Even if the information shows that the insured was not entitled to all of the coverage he claimed, the bad faith claim will go to the jury. It is respectfully submitted that such a result should not be, and is not, the law, but was reached under the majority's mistaken view of the facts.

VII. The Punitive Damage Award—a Proposed Solution to the Error.

Insurance companies, as the Court is aware, rely heavily on a system of actuarial predictions concerning risk, claims and associated expenses as well as the rate of premiums the company must charge to stay competitive while still maintaining an adequate level of reserves. In mutual companies, such as Nationwide, the actuarial process is all the more critical because each insured is also technically an insurer. *See* Keeton, *Hornbook on Insurance Law* § 1.4 (West 1971). Insurance actuaries do more than merely translate the company's risk into raw numbers wherefrom premiums are computed. The expenses of claims administration and litigation costs must also be considered. For that reason, it is vitally important that coverage disputes be characterized by some level of predictability. Otherwise a company is incapable of actuarially managing the policies it writes, and flirts with disaster depending upon the outcome of a single litigated coverage dispute.

At Nationwide, this single judgment (if affirmed) will exceed all of the premiums collected on individually underwritten health policies in Alabama over the last three years. (See Affidavit of Stephen A. Rish attached hereto in the Appendix

at A-1) It will almost equal Nationwide's total 1984 G.A.A.P. underwriting gain on all individually underwritten health insurance the company has in force in the entire United States. *Id.* It is the second-highest bad faith verdict ever affirmed in Alabama, and is over $1 million dollars more than the only other "first tier" bad faith affirmance. In *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916 (Ala. 1981), decided less than four years ago, this Court remitted a $1.1 million dollar verdict to $100,000, noting it was "obviously the result of passion and prejudice on the part of the jury." The disparities, however, do not end at the comparison of judgments. As discussed in Section V, conduct which once was not considered bad faith is now held to warrant punishment by $1.25 million dollars in exemplary damages.

Predictability is gone from this area of the law. Insurance defense counsel can no longer advise clients on how to evaluate cases containing bad faith claims because no one knows what bad faith is anymore. Is bad faith a willful and malicious refusal to pay without any arguable basis of law or fact, or has it now become a remedy for mere "uncooperative, intransigent behavior?" (M.S. at 24) Furthermore, with verdicts ranging from $23,000 to as high as $3.5 million dollars, and remittitur being ordered under no apparent guiding standard, the actuary's (and defense counsel's) job is somewhat akin to throwing knives while blindfolded. In one of the Exhibits to the motion filed herewith today, Nationwide has charted the spasmodic trend of bad faith verdicts over the past four years. It is submitted that either the majority has lost its former perspective concerning the relationship of the punishment to the wrong, or there has been a significant change in the Court's philosophy not expressed in any of its recent opinions concerning the law of bad faith.

The purpose of this discussion is not merely to emphasize the problems created by the inconsistent manner in which bad faith damage verdicts have recently been reviewed, but to offer by way of suggestion some guidelines for assessing punitive damages in such cases in the future. The natural hostilities

exhibited by juries (some more so than others) make it absolutely necessary that the Court take a more active role in reviewing the damage awards in bad faith cases than in other cases. As noted in *Aspinwall v. Gowens*, 405 So.2d 134 (Ala. 1981), the Court cannot allow a jury to do injustice in the name of doing justice. *Id.* at 137. Further authority for taking an active role in reviewing bad faith punitive damage awards is found in *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916 (Ala. 1981), wherein the Court stated that although punitive damages are largely discretionary with the jury, "this discretion is not absolute." *Id.* at 925. A jury, for example, cannot award "all the gold in Fort Knox." A line must be drawn somewhere, but where?

Professor Prosser teaches that besides punishing the defendant the purpose of punitive damages is twofold: to teach the defendant not to do it again, and to serve as an example to others. Prosser, *The Law of Torts* § 2 (4th Ed. 1971). However, when a punitive damage award is rendered under circumstances in which the size of the award affects innocent third parties, such as present and future policyholders in this instance, it goes beyond that purpose. The Fifth Circuit Court of Appeals is now wrestling with that problem in the context of asbestos litigation, wherein enormous punitive damage awards could eventually so deplete funds as to leave future claimants without adequate relief. While many distinctions can be drawn between asbestos litigation and bad faith litigation, a common question is presented as to whether traditional common law rules governing punitive damages are just and appropriate in light of all the circumstances existing today.

If the courts merely stand by, waiting for legislative action, the golden egg may disappear. Our communities cry out for cheaper insurance rates on one hand, and then unwittingly strike devastating blows to themselves with the other by returning enormous punitive damage verdicts against insurance companies. The solution is not simple, but Nationwide suggests that the Court can create order out of disorder by better defining what is meant by a punitive award that is "shocking" to

the conscience. Some type of standard is needed. For example, while a precise mathematical correlation to compensatory damages may not be the answer for every case, the Court can and should define a point beyond which a punitive damage award becomes "shocking." In anti-trust cases, wherein large sums are usually involved, damages are limited to three times the compensatory award. Nationwide submits that such an approach furnishes a reasonable guideline for assessing punitive damages in "bad faith" cases as well. Some "rule of thumb" as to what constitutes "shocking" would leave plenty of room for jury discretion, while at the same time keep the jury from succumbing to passion or prejudice and going "out of control." Furthermore, the bench and bar, as well as insurance companies, would have some consistent guidelines within which to evaluate punitive damage claims.

The foregoing suggestion is rather simplistic, and is meant to be so. It is also meant to be a fair and reasonable solution to a serious and far-reaching problem. However, regardless whether the Court decides to embrace this proposal or another alternative, such as the proposals of Chief Justice Torbert and Justice Maddox involving extra-contractual damages (see the dissenting opinions in *Lavoie* and *Kountz*), Nationwide submits it would be a serious miscarriage of justice to let the existing punitive damage award stand in this case. Nationwide perceived a fraudulent attempt by the plaintiff to recover more than he was entitled to under the policy, and was at least partially successful in its defense. It should not now be assessed punitive damages for what was obviously a legitimate argument. At the very least, a substantial remittitur is in order.

Stated simply, 3½ years ago this Court, not the Legislature, created or "recognized" the tort of bad faith with respect to insurance contracts. That tort has suddenly blown wide open. It is now the duty of this Court, not the Legislature, to fashion some acceptable means of controlling the amount of punitive damage bad faith awards. Otherwise this Court will be responsible for insurance becoming unavailable or prohibitively ex-

pensive for the citizens of this state. (See, e.g., the Affidavit of Stephen A. Rish at Appendix A-1)

VIII. Mr. Justice Embry's Personal Interest in Shaping the Law of Bad Faith Renders This Court's Decision Illegal as Violative of Nationwide's Fifth and Fourteenth Amendment Due Process Rights Under the U.S. Constitution.

Nationwide's Motion for Withdrawal of Opinions and Suggestion of Disqualification, filed contemporaneously with this application and brief, together with all exhibits to that motion, are incorporated herein by reference.

The United States Supreme Court's decision in *In re Murchison*, 349 U.S. 133, 99 L.Ed. 942, 75 S.Ct. 623 (1955) stands for the proposition that a defendant's due process rights were violated when the same judge presiding at his contempt hearing had also served as a "one-man grand jury" out of which the contempt charges arose. The Court, speaking through Associate Justice Black, stated in pertinent part concerning the involvement of the Judge in both the grand jury and trial as follows:

> It would be very strange if our system of law permitted a judge to act as a grand jury and then try the very persons accused as a result of his investigations. . . . Having been a part of that process, a judge cannot be, in the very nature of things, wholly disinterested in the conviction or acquittal of those accused. While he would not likely have all the zeal of a prosecutor, it can certainly not be said that he would have none of that zeal. Fair trials are too important a part of our free society to let prosecuting judges be trial judges of the charges they prefer.

349 U.S. at 137, 99 L.Ed. at 946. In the instant case, a judge has acted as a plaintiff in a bad faith class action suit against an insurance company, and at the same time "tried" other insurance companies for that very tort. While Mr. Justice Embry may not possess the same zeal as the plaintiff in the instant suit, by no stretch of the imagination can it be said that he

would have *none* of that zeal. That is particularly true considering the interest of Mr. Justice Embry in revitalizing and then expanding the application of the tort of bad faith, as well as in affirming (without remittitur) excessively large damage awards in such "bad faith" cases. It is the appearance of even a modicum of that interest that taints this Court's opinion, renders it illegal due to violation of Nationwide's Fifth and Fourteenth Amendment due process rights under the U.S. Constitution, and mandates a withdrawal of this Court's decision.

It is only human that one who is currently prosecuting a claim for bad faith against an insurance company would have a natural bias or adverse interest against another insurance company, appearing before the Court on which that person is sitting, on a similar charge. The logic of this natural human tendency was pointed out in *In re Murchison, supra*, by the U.S. Supreme Court as follows:

> As a practical matter, it is difficult if not impossible for a judge to free himself from the influence of what took place in his 'grand jury' secret session. His recollection of that is likely to weigh far more heavily with him than any testimony given in the open hearings.

429 U.S. at 138, 99 L. Ed. at 947. In the instant case, Mr. Justice Embry's personal involvement as the only named plaintiff in a bad faith action against Blue Cross-Blue Shield makes it almost impossible for him to "free himself from the influence" of that suit. Indeed, the extent of Justice Embry's bias and ill-will is borne out by his request for punitive damages as well as damages for "breach of contract, *inconvenience, emotional and mental distress, disappointment, pain and suffering.*" (Blue Cross-Blue Shield Complaint, p. 11, Exhibit B to Nationwide's motion of this date).

Nationwide submits there is more than a mere "appearance" of bias, pecuniary interest or partiality in this case. The inescapable conclusion is that Justice Embry, by his involvement in a parallel bad faith case, deprived Nationwide of its constitutional rights to due process. Anything less than a de novo

rehearing pursuant to Alabama Code § 12-2-14 (1975) would be contrary to the standards of judicial ethics required of all judges in this state.

IX. The Majority's Application of the Law in This Case, and Its Affirmance of the $1.25 Million Dollar Punitive Damage Verdict, Has Deprived Nationwide of Certain Rights Under the United States Constitution.

The Ex Post Facto Clause of the U.S. Constitution is a limitation upon the powers of the Legislature, and does not apply directly to the judicial branch of government. *See Frank V. Mangum*, 237 U.S. 309, 344, 59 L.Ed. 969, 35 S.Ct. 582 (1915). However, the principle on which that clause is based "is fundamental to our concept of constitutional liberty." *Marks v. United States*, 430 U.S. 188, 191, 51 L.Ed. 2d 260, 97 S.Ct. 990 (1977). Persons have a right to fair warning of any conduct that will give rise to punishment, and that right is protected against judicial action by the due process clause of the Fifth Amendment. *Marks v. United States*, 430 U.S. at 192. The Court in *Marks*, *supra*, observed that an unforeseeable judicial enlargement of a criminal statute, applied retroactively, operates precisely like an ex post facto law. *Id.* If a state legislature is barred by the Ex Post Facto Clause from passing retroactive laws, "it must follow that a state Supreme Court is barred by the due process clause from achieving precisely the same result by judicial construction." *Id.* Although *Marks* involved the violation of a quasi-criminal statute, Nationwide submits that its reasoning applies with equal force in this case.

When Clay applied for disability insurance in December, 1976, and throughout the pendency of his claim in 1978, the tort of bad faith had not even been recognized in Alabama. When Clay initially filed suit, there was still no tort of bad faith. Furthermore, when this case was tried in December of 1983, the then recognized tort of bad faith was limited to application only in cases wherein the insurer had intentionally denied coverage without any arguable basis of law or fact, coupled with actual knowledge of that fact. *See Chavers v. National*

Sec. Fire & Cas. Co., supra; Gulf Atlantic Life Ins. Co. v. Barnes, supra. Now, however, the tort of bad faith has been enlarged to provide a remedy for alleged "uncooperative" and "intransigent" behavior (M.S. at 24) regardless of whether the insurance company has asserted any legitimate legal arguments or factual defenses.

How could Nationwide have known in 1978 that the Alabama Supreme Court, seven years later, would impose such stringent duties upon an insurer by upholding a $1.25 million dollar punitive damage verdict against Nationwide for mere "uncooperative, intransigent behavior?" This sudden enlargement of the tort of bad faith clearly violates Nationwide's due process rights against retroactively enlarged laws. For that reason, the majority's opinion should be withdrawn upon rehearing and substituted by a decision reversing the punitive damage verdict against Nationwide.

CONCLUSION

The situation presently existing compels the withdrawal of the February 8 opinion, the recusal of all the justices of this Court, and the appointment of a Special Court pursuant to Alabama Code § 12-2-14 (1975) to consider this appeal de novo.

Respectfully submitted,

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FORREST S. LATTA

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CERTIFICATE OF SERVICE

Case Number 82-536
82-917

NATIONWIDE MUTUAL INSURANCE COMPANY,
Appellant,

v.

HENRY GERRARD CLAY,
Appellee.

I hereby certify that I have this day served a copy of the foregoing Application for Rehearing and Supporting Brief upon counsel of record for the Appellant, Fred W. Killion, Jr., Esquire, Post Office Box 8158, Mobile, Alabama 36608, by placing a copy of same in the United States mail, properly addressed and first class postage prepared.

Dated this 22nd day of February, 1985.

FORREST S. LATTA

APPENDIX

Affidavit of Stephen A. Rish, Associate Vice President, Nationwide Mutual Insurance Company A-1

First State Ins. Co. v. Wallace, No. 83-7206, Slip op. (11th Cir. March 6, 1984) A-2

Excerpt from "Reply Brief of Henry Gerrard Clay, Plaintiff, In Opposition to the Defendant's Motion for Partial Summary Judgment." A-10

AFFIDAVIT

Personally appeared before me, a notary public in and for the State of Ohio, Stephen A. Rish, Associate Vice President Individual Life and Health Operations, who being duly sworn states:

That the GAAP (Generally Accepted Accounting Practices) earned premium income from the Nationwide Mutual Insurance Company's individually underwritten health policies in force in the State of Alabama was $1,292,864 (for the years 1982 to 1984 inclusive).

That for the year 1984 the gross, pre-tax, earnings on all the Company's individually underwritten health policies in force in the U.S. was $1,825,000 on total written premium of $30,072,980.

That a working group consisting of actuarial, operations, claims and management personnel has been directed to study the feasibility of continuing to issue and otherwise conduct individually underwritten health insurance business in the State of Alabama.

Given under his hand and seal at Columbus, Franklin County, Ohio this 19th day of February, 1985

Stephen A. Rish
Associate Vice President
Individual Life and Health Operations
Nationwide Insurance Companies
Columbus, Ohio

William T. Clark

IN THE
UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 83-7206
Non-Argument Calendar

FIRST STATE INSURANCE COMPANY,
Plaintiff-Appellee,

VERSUS

GERALD L. WALLACE:
GERALD L. WALLACE d/b/a
BATTLE HOUSE,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Alabama

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(March 6, 1984)

Before HILL, JOHNSON and HENDERSON, Circuit Judges.

PER CURIAM:

This is an appeal from the entry of summary judgment by the United States District Court for the Southern District of Alabama in favor of First State Insurance Company on a claim by Gerald L. Wallace: Gerald L. Wallace d/b/a/ Battle House, for bad faith refusal to pay benefits under an insurance contract. Summary judgment was entered by the district court after a nine-day trial on the merits of the insured's claim under the

insurance policy, which resulted in a verdict of more than $200,000 less than the insured's sworn claim.

The only issues presented on this appeal are (1) whether the district court applied the correct legal standard under Alabama law for determining whether an arguable basis existed for the insurer's failure to pay the insured's claim, and (2) whether the district court abused its discretion in determining that further discovery was unnecessary prior to the entry of the summary judgment.

We AFFIRM on the basis of the district court's order on the motion for summary judgment, a copy of which is attached hereto.

IN THE
UNITED STATES DISTRICT COURT FOR THE
SOUTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

Civil Action No. 82-0438-C

FIRST STATE INSURANCE COMPANY, ETC.,
Plaintiff,

VS.

GERALD L. WALLACE, ET AL.,
Defendants.

ORDER ON MOTION FOR SUMMARY JUDGMENT

This matter is before the court on the motion for summary judgment filed by the counterclaim-defendant First State Insurance Company ("First State") on the second cause of action alleged in the counterclaim of counterclaim-plaintiff Dr. Gerald L. Wallace ("Wallace"). This is the only claim left unresolved in

this case. The court has considered the matter, reviewed the briefs filed by counsel for both parties, and heard oral argument.

FINDINGS OF FACT

The court finds that the following facts are undisputed:

1. Jurisdiction is invoked pursuant to 28 U.S.C. § 1332 as to which there is no contest.

2. An examination of the materials on file together with the court's charge to the jury in Case No. 87-756 (the declaratory judgment action filed by First State to resolve the question of First State's liability to Wallace under the policy), which this court judicially notices, reflects that the following facts are undisputed:

(a) First State issued its Policy No. 711979 ("the policy"), effective August 14, 1979, insuring the vacant Battle House building (policy limits of $525,00.00) and its contents (policy limits of $75,000.00), against loss caused by windstorm, subject to all the terms, limitations, conditions, and provisions of the policy. The named insured is Gerald L. Wallace d/b/a/ THE BATTLEHOUSE ("Wallace"). (Plaintiff's Exhibit No. 1 at trial.)

(b) The policy set forth certain requirements of the insured in case loss occurs, including (a) the requirement to protect the property from further damage; (b) the requirement to render to First State a proper proof of loss. The policy further expressly provided that the "entire policy shall be *void* if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof . . . *or* in case of any fraud or false swearing by the insured relating thereto." (Plaintiff's Exhibit No. 1 at trial.)

(c) On September 12, 1979, the Battle House sustained some damage caused by Hurricane Frederick, a "windstorm" within

the meaning of the policy. (See First State's Complaint and see Wallace's Answer.)

(d) Wallace submitted an "Amended Sworn Statement in Proof of Loss" on August 21, 1980, claiming loss in the amount of $518,167.65 excluding interest. (Plaintiff's Exhibit No. 3 at trial.)

(e) On November 21, 1980, First State filed a declaratory judgment action seeking a judgment declaring, cumulatively and alternatively, *inter alia:* (1) that Wallace failed to satisfy the policy's proof-of-loss requirements; (2) that the coverage under the policy was void by reason of Wallace's concealment and misrepresentation of material facts concerning the subject of the insurance; and (3) the extent, if any, of First State's liability under the policy. (See First State's Complaint)

(f) Wallace's answer asserted a counterclaim, alleging liability of First State for bad faith refusal to pay a valid claim under an insurance policy. This court severed Wallace's bad faith claim for a separate trial and judgment.

(g) In July, 1982, this court conducted a nine day trial on First State's declaratory judgment action. The case was submitted to the jury for a general verdict. (Exhibit 7 to Motion.) Among the issues submitted to the jury were: (1) whether the policy was void by reason of Wallace's concealment or misrepresentation of material facts concerning the subject of the insurance, and (2) the extent, if any, of First State's liability under the policy. (Exhibit 7 to Motion.) First State waived jury trial on the issue of the sufficiency of Wallace's proofs of loss, and the court thereafter determined that the proof of loss submitted by Wallace on August 21, 1980, satisfied the requirements of the policy.

(h) The jury returned a verdict for $371,269.88, including interest. The verdict is $202,009.00 less than the amount claimed by Wallace in his August 21, 1980 "Amended Sworn Statement in Proof of Loss" ($518,167.65 plus interest at 6% annually less the amount of the verdict). Judgment was entered

on the verdict on August 2, 1982, and the judgment was paid and satisfied by First State on August 12, 1982. (Exhibit 8 to Motion.)

CONCLUSIONS OF LAW

1. Bad faith is the intentional failure by the insurer to perform the duty implied by law to act in good faith and to deal fairly. An actionable tort arises for an insurer's intentional refusal to settle a direct claim where there is either "(1) no lawful basis for the refusal coupled with actual knowledge of that fact, or (2) intentional failure to determine whether or not there was any lawful basis for such refusal." *Chavers v. National Security Fire Ins. Co.*, 405 So.2d 1 (Ala. 1981).

2. No lawful basis means that the insurer lacks a legitimate or arguable reason to pay the claim. When a claim is fairly debatable, the insurer is entitled to debate it, whether the debate concerns a matter of fact or law. "Coupled with actual knowledge of that fact" implies conscious doing of wrong. *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916 (Ala. 1981).

3. The plaintiff in a bad faith case has the burden of proving:

(a) an insurance contract between the parties and breach thereof by the defendant;

(b) an intentional refusal to pay the insured's claim;

(c) the absence of any reasonably legitimate or arguable reason for that refusal (i.e. the absence of a debatable reason);

(d) the insurer's actual knowledge of the absence of any legitimate or arguable reason; and

(e) if the intentional failure to determine the existence of a lawful basis is relied upon, the plaintiff must prove the insurer's intentional failure to determine whether there is a legitimate or arguable reason to refuse to pay the claim.

"In short, the plaintiff must go beyond a mere showing of nonpayment and prove a bad faith nonpayment, a nonpayment without any reasonable ground for dispute. Or, stated dif-

ferently, the plaintiff must show that the insurance company had no legal or factual defense to the insurance claim." *National Savings Life Ins. Co. v. Dutton*, 419 So.2d 1357 (Ala. 1982).

4. "In order for a plaintiff to make out a prima facie case of bad faith refusal to pay an insurance claim, the proof offered must show that the plaintiff is entitled to a directed verdict on the contract claim and thus, entitled to recover on the contract claim as a matter of law. Ordinarily, if the evidence produced by either side creates a fact issue with regard to the validity of the claim and thus, the legitimacy of the denial thereof, the tort claim must fail." *National Savings Life Ins. Co. v. Dutton*, supra.

5. The evidence at trial failed to justify a directed verdict on Wallace's contract claim under the policy. This establishes, as a matter of law, that First State had an "arguable basis" (as defined by the Alabama Supreme Court) for not paying Wallace's claim. In addition to the fact issue relative to First State's liability, the declaratory judgment action also involved a substantial fact issue relative to the *amount* of that liability, which in light of the way the jury resolved it cannot be considered insignificant.

6. The absence of any "arguable basis" for an insurer's denial of an insured's claim is an essential prerequisite for "bad faith" liability in Alabama. Since First State had an "arguable basis" for not paying Wallace's claim, there is no genuine issue of material fact regarding First State's non-liability for the tort of "bad faith."

7. The court is of the opinion that further discovery in the case at bar would be futile.

8. First State is entitled to judgment as a matter of law on the second cause of action alleged in the counterclaim of counterclaim-plaintiff Wallace. Therefore, the motion for summary judgment filed by First State is GRANTED, and the court will by separate document enter judgment in favor of First State.

DONE this 22 day of February, 1983.

UNITED STATES DISTRICT JUDGE

IN THE
CIRCUIT COURT OF MOBILE COUNTY, ALABAMA

Civil Action No. CV-78-001148-K

HENRY GERRARD CLAY,
Plaintiff,

VS.

NATIONWIDE MUTUAL INSURANCE COMPANY,
Defendant.

REPLY BRIEF OF HENRY GERRARD CLAY, PLAINTIFF, IN OPPOSITION TO THE DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

FRED W. KILLION, JR.
ROBERT E. CLUTE, JR.
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PHILIPS, KILLION & BROOKS,
P.C.
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STATEMENT OF FACTS

The Plaintiff, Henry Gerrard Clay, applied for disability insurance with the Defendant by application dated December

8, 1976. The Defendant issued a policy of disability insurance number AH-1167980 with an effective date of January 19, 1977. Thereafter on or about August 29, 1977, due to the formation of cataracts on both eyes Henry Gerrard Clay became disabled. Henry Gerrard Clay submitted a claim to the Defendant on September 13, 1977. No payment was authorized by the Defendant until February 7, 1978. *The Plaintiff claims that under their contract he was entitled to $44,910 in total benefits and a premium waiver of $3,652.08 for a total of $48,562.08, not including interest.*

For the sake of brevity, the Plaintiff will try not to burden the Court by reciting duplicated facts already set out in the Defendant's brief. Rather, there are areas of disputed facts and facts which the Defendant's brief either omits, or does not treat sufficiently which are set out below. The crucial facts for purposes Mr. Clay's bad faith claim are the treatment of his claim from the submission of the attending physician's statement up to Mr. Harker's letter of January 16th denying the claim and his letter of March 7th to the Alabama Insurance Commissioners office. These letters are attached hereto as EXHIBITS "1" and "2".

* * * *

ascertained that the Defendant's income at $40,000.00 per year was sufficient to qualify for the policy. It is our contention that Mr. Clay's income was sufficient to support the policy and in fact figures of the deposits in Mr. Clay's law practice have been made available to the Defendants. It is our contention that the Defendant owed benefits at a rate of six (6) months at $1,300.00 per month equaling $7,800.00, forty-one (41) months at $900.00 per month, equaling $36,900.00 and seven (7) days at $30.00 per day, equaling $210.00, for a total of $44,910.00. This does not include interest. In addition, we contend that there was due to be a waiver of premiums in the amount of $3,652.08, which comes to an approximate total of $48,562.08, which we claim was owed to Mr. Clay under the policy. The relations to earnings clause on page 5 of the policy which is attached hereto for the Court's convenience, states in pertinent part,

"RELATION OF EARNINGS TO INSURANCE: If the total monthly amount of loss of time benefits promised for the same loss under all valid loss of time coverage upon the insured, whether payable on a weekly or monthly basis, shall exceed the monthly earnings of the insured at the time disability commenced or his average monthly earnings for the period of two years immediately preceding a disability for which claim is made, whichever is greater, the company will be liable only for such proportionate amount of such benefits under this policy as the amount of such monthly earnings or such average monthly earnings of the insured bears to the total amount of monthly benefits for the same loss under all such coverage upon the insured at the time such disability commences and for the return of such part of the premiums paid during such two years as shall exceed the prorata amount of the premiums for the benefits actually paid hereunder; *but this shall not operate to reduce the total monthly amount of benefits payable under all such coverage upon the insured below the sum of $200.00 or the sum of the monthly benefits specified in such coverages, whichever is lesser or shall operate to reduce benefits other than those payable for loss of time.*"

It is our position that even should the relations to earnings clause apply, *which we contend it should not*, that there would still be a minimum payment of $200.00 per month due Mr. Clay. Further, the waiver of premium provision found on page 3 of the policy states,

"WAIVER OF PREMIUM DURING TOTAL DISABILITY:

If such injury or such sickness results in total disability for which an indemnity is payable under the Total Disability Benefit, the Company will waive payment of any premium falling due within the period for which such indemnity is payable, provided the Insured is totally disabled at least ninety consecutive days immediately preceding the due date of the premium."

APPENDIX F

82-426 & 82-1152 *Aetna Life & Casualty Co., Inc. v. Margaret W. Lavoie and Roger J. Lavoie, Sr.*

ON MOTION FOR DISQUALIFICATION AND APPLICATION FOR REHEARING

Per Curiam.

Pending appellant's application for rehearing, the appellant has filed a motion in this cause styled "Motion for Disqualification and Motion for Withdrawal of Opinion of December 7, 1984 and for Hearing De Novo."

Upon consideration, the Court is of the opinion that under allegation of said motion in this case each justice should vote individually on the matter of whether or not he or she is disqualified and should recuse. Each justice having voted not to recuse,

IT IS, THEREFORE, ORDERED that the "Motion for Disqualification and Motion for Withdrawal of Opinion of December 7, 1984, and for Hearing De Novo" be, and the same is hereby, denied.

Faulkner, Almon, Embry, Beatty, and Adams, JJ., concur.

Torbert, C. J., and Maddox, Jones, and Shores, JJ., concur specially, with opinions by Torbert, C.J., and Maddox, J.

APPLICATION FOR REHEARING OVERRULED.

Faulkner, Jones, Almon, Embry, and Adams, JJ., concur.

Torbert, C.J., and Maddox, Shores, and Beatty, JJ., dissent.

82-426 & 82-1152 *Aetna Life & Casualty Co., Inc. v. Margaret W. Lavoie and Roger J. Lavoie, Sr.*

TORBERT, CHIEF JUSTICE (concurring specially as to the ruling on the motion for disqualification).

I am in accord with the views expressed herein by Justice Maddox with respect to the issue of whether the Court as a body, or the individual justices, should make the determination as to the disqualification of one or more of its members. I agree on the basis of the American Bar Association standards cited; but more importantly, the alleged disqualification here is more subjective than objective, as would be the case where a judge is related to a party or counsel or where a judge has a direct financial interest in the outcome of litigation. The question of disqualification under the factual assertions of appellant's motion addresses itself to the ethical judicial conscience of each justice applied in accordance with the established rules of law set forth in the opinion by Justice Maddox.

Appellant contends that I am disqualified because, I "may have an interest as a possible class member plaintiff in the circuit court action filed by Justice T. Eric Embry and as such [have] an interest that could be substantially affected by the outcome of this case."

I have stated my opinion in the dissent filed in this case on its original deliverance. Moreover, my views have also been expressed in other similar cases heard before this Court. I find them altogether consistent. In addition, I have carefully reviewed my file in this matter throughout the time of its consideration before the Court, both upon its original submission on briefs and after that submission was withdrawn and the case was again submitted after oral argument. The filing of actions by a fellow justice against other insurers in no way influenced or affected my consideration of this appeal.

As to the class action aspect of the allegations of appellant's motion, I too, will not allow myself to be included in the alleged class. The circuit court where the action is pending will be so advised.

It is obvious that the Court had great difficulty in the resolution of this appeal. The case was hotly contested in the trial court by able counsel, strongly argued here, and affirmed by a divided Court. It is indeed unfortunate that the litigation has resulted in a serious charge impugning the honesty and integrity of the Court and its members.

Aetna Life & Cas. Co. v. Margaret Lavoie, et al.

MADDOX, JUSTICE (Concurring specially as to the ruling on the motion for disqualification).

Aetna's Motion for "Disqualification and Motion for Withdrawal of Opinion of December 7, 1984, and for Hearing De Novo," in pertinent part reads as follows:

> "COMES now the Appellant, AETNA LIFE INSURANCE COMPANY, and moves Justice T. Eric Embry to disqualify himself from considering the Appellant's pending application for rehearing, that the remaining Justices of this Court disqualify themselves as Justices considering the appellant's pending application for rehearing, for this Honorable Court to withdraw its opinion of December 7, 1984, which affirmed the verdict of the trial court, for the Clerk of the Supreme Court to certify the disqualifictions of the Justices to the Governor of the State of Alabama in accordance with § 12-2-14, *Code of Alabama, 1975*, and for the special court to hear this case *de novo*. As grounds for said motion, appellant states as follows:
>
> "1. That on Janurary 19, 1984, after this case was submitted to this Honorable Court for consideration, Justice T. Eric Embry filed an action in the District Court of Jefferson County, Alabama, which is styled as follows, *T. Eric Embry v. Maryland Casualty Company*, Civil Action No. DV-84-00963, which was dismissed on April 6, 1984 . . . .
>
> "2. That on January 30, 1984, after this case was submitted to this Honorable Court for consideration,

Justice T. Eric Embry filed an action in the Circuit Court of Jefferson County, Alabama, which is styled as follows, *T. Eric Embry, etc. v. Blue Cross/Blue Shield of Alabama*, Civil Action No. CV-84-500-447, and which is still pending in the Jefferson County Circuit Court. . . .

"3. In the Circuit Court of Jefferson County lawsuit against Blue Cross/Blue Shield, Justice T. Eric Embry alleges on behalf of himself and on behalf of a class of all state employees, among other things, that the failure of the defendant insurance company to pay a portion and delays in the payment of his claim by the defendant insurance company were committed in bad faith. In the District Court of Jefferson County lawsuit, Justice T. Eric Embry, individually, alleged that the defendant insurer in bad faith refused to pay his claim. Both cases demanded the imposition of punitive damages against the respective defendant insurers.

"4. On February 14, 1985 and/or February 15, 1985, the appellant, through its attorneys, was made aware that Justice T. Eric Embry was a party plaintiff in the suits alleging bad faith. . . .

"5. Under the *Alabama Canons of Judicial Ethics*, Canon 3.C(1) (d) (ii), a Judge should disqualify himself in a proceeding in which his impartiality might reasonably be questioned if the Judge has an interest that could be substantially affected by the outcome of the proceeding. Further, the law of Alabama, as set forth in the attached brief, clearly mandates that Justice T. Eric Embry was disqualified from considering and participating in this case and that each Justice of this Court is also disqualified.

"6. Each Justice of this Court participated in the Opinion of December 7, 1984, and *may have an interest as a possible class member plaintiff in the Circuit Court action filed by Justice T. Eric Embry and as*

such has an interest that could be substantially affected by the outcome of this case.

"* * * *

"10. Due to the disqualification of Justice T. Eric Embry and all the Justices of this Court, the Court must withdraw its opinion of December 7, 1984, for the Clerk of the Supreme Court to certify these disqualifications to the Governor of the State of Alabama, and for the special court to reconsider *de novo* this case in its entirety, as required by the Due Process Clause of the Fourteenth Amendment to the Federal Constitution.

"11. The undersigned attorneys are duly and legally admitted to practice law by the Supreme Court of Alabama, are now attorneys in good standing of the Bar of this Court and hereby certify that this motion is filed in good faith and is filed because the undersigned have an obligation to the court as well as to our client. We owe the public a duty to aid the administration of justice, to uphold the dignity of the court and to respect its authority. . . ."(Emphasis added.)

As is apparent from the motion itself, the primary thrust of the motion, particularly paragraph 5, is that Mr. Justice T. Eric Embry is disqualified because of the provisions of Alabama Canons of Judicial Ethics, Canon 3.C(1)(d)(ii). Every other Justice is alleged to be disqualified because "[e]ach Justice of this Court participated in the opinion of December 7, 1984, and may have an interest as a possible class member plaintiff in the Circuit Court action filed by Justice T. Eric Embry and as such has an interest that could be substantially affected by the outcome of this case." Canon 3.C(1)(d)(ii) provides:

"C. Disqualification:

"(1) A judge should disqualify himself in a proceeding in which his disqualification is required by law or his impar-

tiality might reasonably be questioned, including but not limited to instances where:

"* * * *

"(d) He or his spouse, or a person within the fourth degree of relationship to either of them, or the spouse of such a person:

* * * *

"(ii) Is known by the judge to have an interest that could be substantially affected by the outcome of the proceeding."

As I understand the motion, it is directed to me only insofar as I "may have an interest as a possible class member plaintiff in the Circuit Court action filed by Justice T. Eric Embry."

Insofar as I am personally concerned, the movant has failed to show that I am disqualified, but to prevent any question on the matter, I am going to request the clerk of this Court to certify a copy of this special concurrence to the Tenth Judicial Circuit, and to notify the Circuit Court that I do not desire to be a member of any class which has been, or may be, certified in *T. Eric Embry, etc. v. Blue Cross/Blue shield of Alabama*, Civil Action No. CV-84-500-447.

Recusal is required only where "facts are shown which make it reasonable for members of the public, or a party, or counsel opposed to question the impartiality of the judge." *Acromag-Viking v. Blalock*, 420 So. 2d 60, 61 (Ala. 1982).

Recusal is not required by a mere allegation of bias unsupported by substantial fact. *Acromag-Viking v. Blalock, supra.* Because I have no personal interest in the action filed by Mr. Justice Embry, I am not disqualified. I have no personal bias against the movant or any other party to the litigation, although my views *on the law* relative to "bad faith" actions is set out not only in my dissent in this case, but in others also.

By writing this special concurrence, I should not be understood as expressing an opinion on the question of whether any other member of this Court should or should not be disqualified, because I believe that the question of recusal of an appellate judge can be decided better by the judge himself.[1] My view comports with the American Bar Association Standards Relating to Appellate Courts, Section 3.42, which provides:

> "3.42 Disqualification of Judges. A judge of an appellate court should be subject to disqualification on the grounds set forth in the Code of Judicial Conduct recommended by the American Bar Association, and in any case in which the judgment under review is one by a court in whose decision he participated as a judge in a lower court.
>
> "*Commentary*
>
> "An appellate judge should be subject to challenge for cause on the same grounds as a trial judge, and also when an appeal involves a review of his own decision. The most difficult problem concerns the procedure to be employed. As in the challenge of a trial judge, if the challenge is sufficient on its face and any reasonable doubt of the judge's disinterestedness is suggested, the judge may be expected to disqualify himself. If he does not do so, in the case of a trial judge factual issues relating to disqualification should properly be determined by another judge. See § 2.32, Standards Relating to Trial Courts. In the case of an appellate judge, however, that procedure would subject the judge to decision of his disinterestedness by official peers with whom he may continue to serve in a collegial capacity in deciding the case. Moreover, because an appellate court decides questions of law rather than fact, the question of an appellate judge's 'bias' is often practically indistinguishable from the question of his views on the law, which are not properly subject to disputation through

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[1]In *Duncan v. Johnson*, 338 So. 2d 1243 (Ala. 1976), I recused myself because a justice had represented one of the parties to the litigation. See also, *Simpson v. City of Montgomery*, 282 Ala. 368, 211 So. 2d 498 (1968).

the recusal procedure. Given these complications, it is better that the question of recusal be decided by the judge himself. If he is a judge of an intermediate appellate court, there remains the remedy of appeal from a decision in which he participates; if he is a judge of a supreme court, reliance must be placed on his recognition that a court should not only be disinterested but that it should appear to be so.

"In some jurisdictions, peremptory challenge of a trial judge is permitted. See Commentary to § 2.32(b), Standards Relating to Trial Courts. This procedure is inappropriate in the case of an appellate judge. In the collegial decision-making of an appellate court an individual judge's purely personal views are of less significance than they would be in a trial court and he is subject to collegial restraint should he be inclined to act on them; an appellate judge has few occasions for exercising the broad discretion reposing in a trial judge; and in appellate litigation there is no occasion for the intense personal interaction between the judge and the lawyers and litigants that may occur in a trial court. Moreover, an appellate judge's established views on law and justice, at least up to a point, are a proper element of the contribution he makes to the function of an appellate court, particularly in the development of the law. A peremptory challenge might easily be abused to exclude a judge solely because a litigant disagreed with his views."

See, also *State ex rel. Wild v. Otis*, 257 N.W. 2d 361 (Minn. 1977); contra: *State ex rel. Short, Atty. Gen., v. Martin*, 256 P. 681 (Okla. 1927) (Supreme Court has power to disqualify any one or more of its members from participating in a case).

In determining that I am not disqualified, I have applied the following test, set out in *Ex parte Cornwell*, 144 Ala. 497, 498-99, 39 So. 354 (1905):

"It is true that the respondent has no direct, pecuniary interest in the result of the prosecution by the State

against the petitioner on the pending indictments. And, if the question of disqualification were left to be determined alone by the terms of the statute, § 2637 of the Code, under the facts in the present case, no disqualification could be said to exist. But, under the common law, there are other grounds than those mentioned in the statute, which go to the disqualification of the judge.

"In *Gill v. State*, 61 Ala. 172, it was said, 'According to the stern morality of the common law, a judge is required to be legally indifferent between the parties.' In *Freeman on Judgments*, § 145, it is said to be 'Well settled by the common law that no judge ought to act where, from interest or any other cause, he is supposed to be partial to one of the suitors.' Any interest, the probable and natural tendency of which is to create a bias in the mind of the judge for or against a party to the suit, is sufficient to disqualify. The judge is human, and human nature at best is weak, and as far as it is possible a perfect equipoise should always be preserved in the administration of justice by the courts. Pecuniary interest in the result of the suit is not the only disqualifying interest. If such were true, there would exist no disqualification in the judge to try a defendant on a charge of arson in the burning of the house of the judge. And yet no one would for a moment question the existence of such an interest in the result of the trial, the probable and natural tendency of which would be to create a bias, that would affect the competency of the judge."

Based on the foregoing, I am of the opinion that it is better that the question of recusal of an appellate judge be decided by the judge himself, and I have determined that the movant has failed to show that I should disqualify myself in this case; therefore, I am of the opinion that the movant's request is due to be denied.